

Aerospace & Defense

Spring 2008

Industry Update

China – Dragon Calls the Shots in the Skies

China continues to propel the engine of the world economy with sustained growth over the last three decades—its gross domestic product (GDP) witnessed a 9.7 percent compounded annual growth rate (CAGR) from 1979 to 2006, with the latest cyclical upswing leading to annual growth rates of more than 10 percent since 2003.¹ The bustling Chinese economy has paved the way for significant expansion of capacity in the aviation sector. In addition, its growing defense expenditure for high-technology military equipment makes China an exciting source of untapped opportunities for the aerospace and defense industry.

Aerospace Sector Ready to Take Off

The booming global aviation industry and surging cargo volume are expected to result in significant capacity expansion in China.

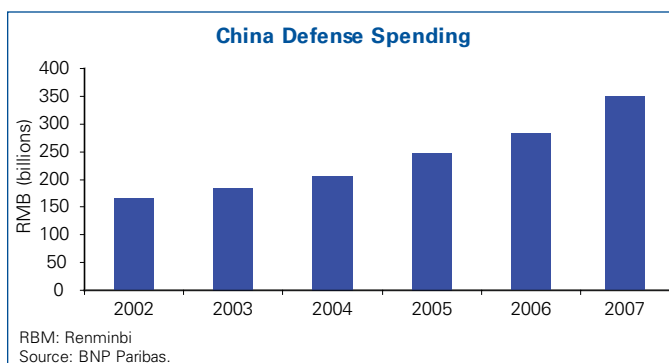
The Civil Aviation Administration of China (CAAC) estimates a 12.9 percent growth in the number of aircraft in China (an increase of around 140 aircraft annually) and a 14 percent CAGR in available tonne kilometers (ATK) from 2006 to 2010.

Aviation Sector Spreads its Wings

The Chinese aviation sector has been fueled by its country's vibrant middle class, with rising disposable income levels, late entry into the air transport market, growing reforms to comply with the World Trade Organization's (WTO) regulations on state-owned enterprises (SOEs), and enhancing the competitiveness of domestic airlines. The emergence of low-cost local carriers, the expanding tourism industry, and the 2008 Beijing Olympics are also expected to provide a significant boost to the aviation industry. Passenger traffic has surged in the past few years and, according

to the CAAC, air passenger volume is expected to grow at a 14.5 percent CAGR from 2006 to 2010. According to CEIC Nomura International estimates, the passenger load factor is also expected to increase significantly from 71.7 percent in 2005 to almost 75.3 percent in 2010. According to Boeing estimates, total revenue passenger kilometers (RPK) in China will remain steady at a 7.2 percent CAGR from 2006 to 2025, compared with 4.7 percent for the rest of the world during the same period. The fast-evolving Chinese aviation industry has also resulted in a string of entries by foreign strategic investors into China's airlines. Notable examples are Cathay Pacific and Soros Foundation acquiring ownership stake interests in Air China and Grand China Airlines, respectively.

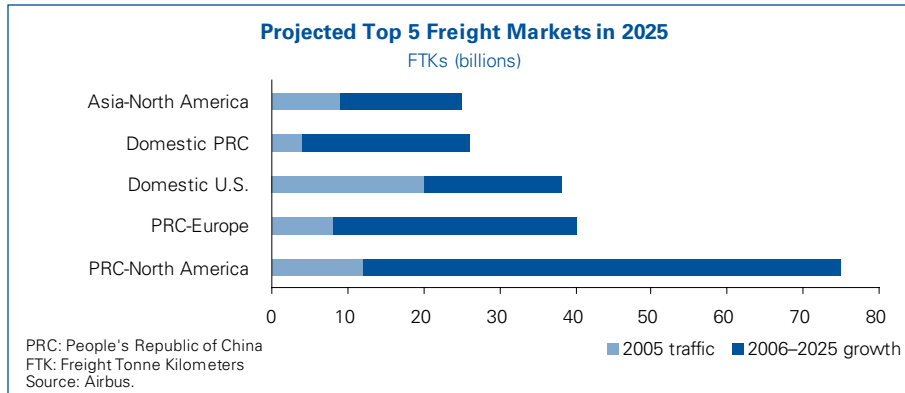
¹ BNP Paribas, October 2007.



Year	RPK growth (%)	ASK growth (%)	Pax load factor (%)	No. of aircraft
2004	41.1	31.7	69.6	754
2005	14.7	11.6	71.5	863
2006	15.9	15.6	71.7	998
2007F	16.0	14.0	73.0	1,138
2008F	15.5	13.5	74.3	1,291
2009F	13.0	12.6	74.5	1,440
2010F	12.0	10.8	75.3	1,580

RPK: Revenue Passenger Kilometers
ASK: Available Seat Kilometers
Pax load factor: Passenger Load Factor

Source: CEIC Nomura International (Hong Kong) Limited.



Cargo Volumes Gaining Weight

In the face of a galloping Chinese economy, rising exports, and increased penetration of Chinese airlines into the international air cargo markets, China is anticipated to generate significant revenue from the domestic and international cargo markets. According to Airbus, total air freight traffic in China, measured in revenue freight tonne kilometers (RFTK), is expected to grow at a 10.5 percent CAGR between 2006 and 2015 (12.6 percent annually for domestic air freight traffic).

Conclusion

China's aerospace and defense industry is expected to continue to experience significant growth in the coming years and will most likely be fueled by China's growing defense budget, increased commercial and cargo aviation, and partnerships with foreign players to modernize China's industrial facilities and capabilities. With increasing demand to address the strain and constant modernization of its growing aviation and defense infrastructure, China will remain a key contributor to the global aerospace and defense industry.

India – Tiger Has No Borders

Indian Civil Aviation Industry Soaring High

The Indian economy has continued to gather momentum, with a GDP growth of 8.6 percent from 2003 to 2007, and is showing no signs of slowing down.² The Indian aviation sector has been marked by fast-paced changes due to strong economic growth and the liberalization of the Indian aviation sector. From an industry that few could afford to participate in, the sector has now graduated to a fiercely competitive one with the presence of a number of private and public airlines.

The Indian aviation sector grew significantly due to a record increase of 38.5 percent in air travelers between 2006 and 2007. According to Airports Council International (ACI), the aviation industry in India is expected to grow at a CAGR of 10.4 percent between 2007 and 2026. Going forward, India will continue to be a driving force behind the world's civil aviation and is expected to move ahead of its Asian counterpart China, and developed countries such as France and Australia.³ Exponential population growth and rising

disposable income of the burgeoning professional class are further expected to fuel India's civil aviation sector.

According to the World Travel and Tourism Council (WTTC), India's travel and tourism industry is expected to grow 9.7 percent annually through 2012. This growth is also expected to significantly contribute to the growing aviation sector. Also, the extension of passenger usage from rail to low-cost airlines is expected to significantly impact the revenue growth of local airline companies.

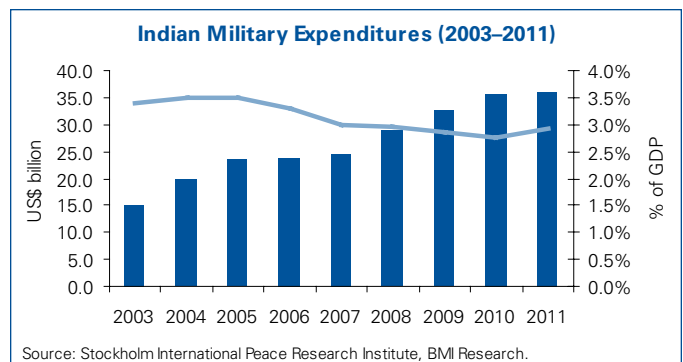
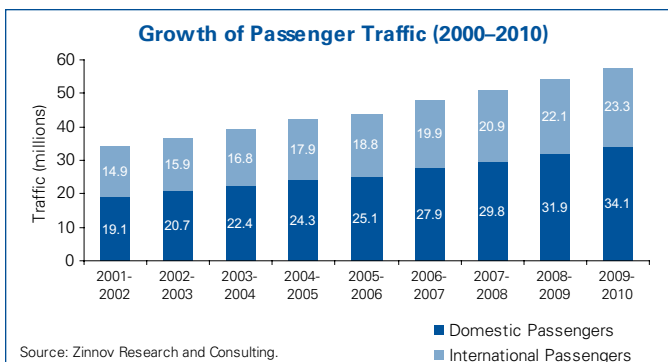
On the regulatory front, progressive government measures are enabling increased foreign investment in Indian airlines with foreign institutional investors (FII), which are now allowed to acquire ownership in domestic airlines beyond the sectoral foreign direct investment (FDI) limit of 49 percent through secondary market purchases.⁴ Furthermore, the Indian government has adopted a liberal approach to granting air traffic rights under bilateral agreements in order to enable greater access to and from India.

As a result of the booming Indian aviation sector, India's Civil Aviation Ministry expects a strong rise in the number of passenger planes in India from a modest level of 260 in 2007 to 1,500 to 2,000 in the next 10 years. In the short term, the Civil Aviation Ministry expects India's commercial airline fleet to double by 2010.

² Reuters News, "Indian Economy to Grow 9.1 percent in 2008-09 - CMIE," January 14, 2008.

³ Civil Aviation Week, "Industry News Archives," February 15, 2007.

⁴ Indian Brand Equity Foundation, "Airlines on a Buying Spree," October 31, 2007.



KPMG Corporate Finance LLC

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Supplemental Data

Select Aerospace & Defense Transactions

- January 24, 2008 – **Chemring Group plc** (Chemring) (LSE:CHG) definitively agreed to acquire **Titan Dynamics Systems, Inc.**, (Titan) a manufacturer of military-related products, for approximately US\$4.8 million. Marshall, Texas-based Titan manufactures battlefield effects simulators (BES), which are incorporated into the U.S. Army's and Marine Corps' digital training ranges. The acquisition complements Chemring's current range of conventional and cartridge-based military training pyrotechnics.
- January 21, 2008 – **Composix Co.**, a manufacturer of armor products and composite parts, definitively agreed to acquire **Rabintex USA, LLC**, a manufacturer of ballistic armoring equipment, for approximately US\$3 million.
- January 18, 2008 – **QinetiQ Group plc** (QinetiQ), a provider of defense and security scientific and technical solutions, definitively agreed to acquire **Aerostructures Group**, a provider of engineering consulting services, for approximately US\$9.8 million in cash; **Ball Solutions Group Pty. Ltd.**, a provider of strategic and operational consulting services, for approximately US\$10.6 million in cash; and **Novare Services Pty. Ltd.**, a provider of explosive ordnance consulting services, for approximately US\$7.1 million in cash. The acquisition of the three Australian companies is part of QinetiQ's strategy to grow its European, Middle Eastern, and Australian (EMEA) capabilities.
- January 18, 2008 – **Goodrich Corp.** (Goodrich) (NYSE:GR) acquired Fort Worth, Texas-based **Skyline Industries, Inc.**, a provider of crashworthy lightweight military helicopter seats and floor armor, for an undisclosed amount. The acquisition complements Goodrich's fixed-wing aircraft seating capabilities and provides an additional presence in the helicopter market.
- January 18, 2008 – **BAE Systems Australia Ltd.** (BAE) definitively agreed to acquire **Tenix Defence Pty. Ltd.**, (Tenix) a provider of defense products and services, for approximately US\$687 million in cash. The transaction implies a valuation of 1.1x revenue and 13.8x EBIT, based on Tenix's 2007 results. Sydney, Australia-based Tenix supplies and supports military vehicles for the Australian army and provides systems integration, modification, and support for military aircraft. The acquisition adds a major naval business to BAE's portfolio and significantly increases its land capability. The transaction is expected to be completed in the first half of 2008.
- January 15, 2008 – **Cobham plc** (Cobham) (LSE:COB), a manufacturer of aerospace and defense systems, definitively agreed to acquire **Sparta, Inc.**, (Sparta) a provider of scientific, engineering, and technical assistance services, for approximately US\$416 million in cash. The transaction implies a valuation of 1.4x revenue, 13.4x EBITDA, and 15.1x EBIT, based on Sparta's latest 12 months results, as of September 30, 2007. Lake Forest, California-based Sparta provides its services, both as a prime contractor and subcontractor, to the U.S. military and intelligence agencies. The acquisition strengthens Cobham's ability to service the U.S. Department of Defense and intelligence markets. The transaction is expected to be completed in the second quarter of 2008.
- December 24, 2007 – **Teledyne Technologies, Inc.** (Teledyne) (NYSE:TDY), a provider of electronic components and instruments, definitively agreed to acquire **Judson Technologies, LLC**, (Judson) a manufacturer of infrared detectors, for an undisclosed amount. Montgomeryville, Pennsylvania-based Judson manufactures infrared detectors and accessory products for the industrial, military, and space sectors. The acquisition provides Teledyne with a wider range of visible and infrared detectors, integrated subsystems, and camera products. The transaction is expected to be completed in February 2008.
- December 24, 2007 – **BAE Systems, Inc.** (BAE Systems, Inc.) acquired the UK Government and Commercial Software business unit of **Petards Group plc** (Petards) (AIM:PEG), for approximately US\$4.9 million in cash. The transaction represents a valuation of 1.4x Petards' software group's 2006 revenue. Middlesex, United Kingdom-based Petards engages in the development, supply, and maintenance of security and surveillance systems technologies. The acquisition enables BAE to further develop Petards' video surveillance software system, and further penetrate the North American market.
- December 21, 2007 – **BAE Systems, Inc.** definitively agreed to acquire **MTC Technologies, Inc.** (MTC) (NasdaqNM:MTCT), for approximately US\$450 million. The transaction implies a valuation of 1.0x revenue and 11.7x EBITDA, based on MTCT's latest 12 months results, as of September 30, 2007. Dayton, Ohio-based MTC provides technical and professional services to the U.S. military and intelligence agencies. The acquisition is part of BAE Systems, Inc.'s strategy to grow its six core markets, including the U.S., as well as grow its worldwide services. The transaction is expected to be completed in the first half of 2008.
- December 20, 2007 – **Senior plc** (Senior) (LSE:SNR), a manufacturer of industrial technology components and systems, acquired **Capo Industries, Inc.**, (Capo) a manufacturer of highly engineered aerospace components, for approximately US\$85 million in cash. The transaction represents a valuation of 2.9x revenue and 12.3x EBIT, based on Capo's 2007 results. Chino, California-based Capo provides super alloy precision machining and assembly for OEM turbine engines. The acquisition strengthens Senior's presence in the commercial wide-bodied and business jet markets.

Select Aerospace & Defense Transactions

- December 19, 2007 – **Cobham Defense Electronic Systems** definitively agreed to acquire the Surveillance and Attack business of **BAE Systems, Inc.**, for approximately US\$240 million in cash. The transaction implies a valuation of 2.6x revenue and 17.1x EBIT, based on BAE's business unit's 2007 results. The Landsdale, Pennsylvania-based business unit manufactures broadband high-power transmitter and radio frequency front-end systems for military aircraft. The transaction is expected to be completed in the first quarter of 2008.
- December 19, 2007 – **McKechnie Aerospace**, a provider of aerospace support services, acquired **American Turbo Systems, Inc.**, a manufacturer of ground aircraft support equipment, for an undisclosed amount. Tucson, Arizona-based American Turbo manufactures airborne and ground aircraft support equipment, and provides overhaul and repair services. American Turbo will become part of McKechnie's aftermarket support business.
- December 11, 2007 – **TenCate Advanced Composites**, a producer of thermoplastic and thermoset solutions, definitively agreed to acquire **Composix Co.**, a manufacturer of armored products, for an undisclosed amount. Newark, Ohio-based Composix manufactures armor products, machined metallic parts, and composite parts. The acquisition enables TenCate to expand further and acquire a significant position in the growing military vehicles hard armor market in the U.S. The transaction is expected to be completed in the first quarter of 2008.
- December 11, 2007 – **Senior plc** (LSE:SNR), a manufacturer of industrial technology components and systems, acquired **Absolute Manufacturing, Inc.**, a manufacturer of highly engineered aerospace components, for approximately US\$14.6 million in cash. Arlington, Washington-based Absolute specializes in the machining and assembly for high precision aerospace components. The acquisition further strengthens Senior's presence in the aerospace and defense sector.
- December 10, 2007 – **Volvo Aero AB**, a manufacturer of technology components for aircraft, rocket, and gas turbine engines, and a subsidiary of Volvo AB (OM:VOLV A), acquired **Chelton Applied Composites AB**, a manufacturer of composites, for an undisclosed amount. Sweden-based Chelton manufactures and supplies composite materials for the aerospace and defense sectors.
- December 5, 2007 – **Edac Technologies Corp.** (NasdaqSC:EDAC), a manufacturer of aerospace components, acquired the repair business unit of **MTU Aerospace Engines North America**, for an undisclosed amount. The Newington, Connecticut-based business unit provides precision machining for the maintenance and repair of aircraft engine components. The acquisition enables Edac to strengthen its presence in the engine repair market.
- December 3, 2007 – **Ultra Electronics Holdings plc** (LSE:ULE), a manufacturer of aerospace and defense electronic systems, acquired **BCF Designs, Ltd.**, a provider of aerospace testing solutions, for approximately US\$24.5 million in cash. Gloucestershire, United Kingdom-based BCF manufactures electronic test solutions for the military and civil aerospace markets. The acquisition complements Ultra's existing fixed and rotary wing military aircraft systems and wiring harness capabilities.
- October 16, 2007 – Private equity firms **KKR Private Equity Investors, L.P.** and **Sageview Capital, LLC** completed their acquisition of a 70 percent interest in **Air Canada Technical Services (ACTS)**, a subsidiary of **ACE Aviation Holdings Inc.**, for CAD\$763 million. Montreal, Canada-based ACTS is a provider of maintenance, repair, and overhaul (MRO) services that include airframe, engine, and component maintenance, to a variety of customers, including airlines. ACTS currently has operations throughout Canada, and in El Salvador. ACTS has disclosed that it intends to continue its expansion outside of Canada, and into the rest of the Americas.
- September 17, 2007 – **Allen-Vanguard Corporation** completed its acquisition of the shares of **Med-Eng Systems Inc.** for CAD\$600 million from private investment firms **Capital Alliance Ventures, GrowthWorks, and Schroders & Associates Canada Inc.** The purchase price values Med-Eng at 2.3x revenue and 6.1x EBITDA. Based in Ottawa, Canada, Med-Eng is a leader in the design and manufacturing of equipment used in the disposal of unexploded explosive devices, and is a supplier to the U.S. military. Allen-Vanguard, also based in Ottawa, specializes in equipment which combats hazardous devices and materials. The acquisition will enable Allen-Vanguard to expand its revenue from U.S. operations, while adding to its customer and product base.

Sources: Company filings and press releases, Infobasepub.com.

More Cargo Planes to Address Greater Demands

Both mounting export volumes, especially from chemical and high-value pharmaceuticals, and booming retail and logistics sectors, are driving growth in India's international and domestic air cargo traffic, respectively. According to the Associated Chambers of Commerce and Industry of India (ASSOCHAM), India's domestic cargo sector witnessed phenomenal growth of more than 33 percent and international cargo growth of 15 percent in 2007. This emerging sector has resulted in pressing demand for cargo aircraft—approximately 500 cargo planes are expected to take flight over the Indian skies by 2017. The demand for defense cargo aircraft is also not far behind; Lockheed Martin is set to enter India through a US\$1 billion deal to supply C130J Hercules cargo aircraft to the Indian Air Force (IAF) in the coming years.

Defense

India's objective to strengthen its military as an element in shaping its foreign policy and establishing India as a major regional power with a modernized arsenal, is one of the major driving forces behind its increasing defense expenditure. India's defense spending almost doubled last year, reaching US\$25 billion in 2007. Defense expenditure in the future is also expected to be influenced by the continuing tensions with Pakistan and the ever-present threat of insurgency.

India is currently capable of manufacturing military equipment, including main battle tanks (MBT), a variety of short and medium-range ballistic missiles, surface-to-air missiles (SAM), and light combat aircraft (LCA), along with small

arms, ammunition, artillery, and armored transports.⁵ Despite the country's plans to achieve 70 percent self-reliance with respect to domestic defense-related production, India has fallen short of plan after a decade, as current domestic defense production is only at 42 percent.⁶ Moreover, India still relies considerably on imports, with 35 percent to 40 percent of India's defense coming from Russia.⁷

India is expected to import US\$30 billion worth of military equipment within the next 5 years, with foreign vendors continuing to transfer technology and supply defense armaments, such as fighter jets, helicopters, and long-range maritime spy aircraft. Given the sheer size of the Indian military and the still-developing research and development within the indigenous defense industry, India will likely continue to look abroad for high-technology and large quantity orders.⁸

Conclusion

With aviation business expected to grow exponentially in the coming years, the demand for new aircraft in India will remain a major agenda for all major industry players. Additionally, despite efforts put forth by India to become self-sufficient, imports of defense equipment will continue to have a major impact on India's defense expenditures.

⁵ Business Monitor International, "India Defense and Security Report Q2 2007," June 2007.

^{6,8} Business Times Singapore, "India's Military Imports to Hit US\$30b: study," May 15, 2007.

⁷ Business Monitor International, "India Defense and Security Report Q2 2007," June 2007.

^{9,10} Thomson Financial.

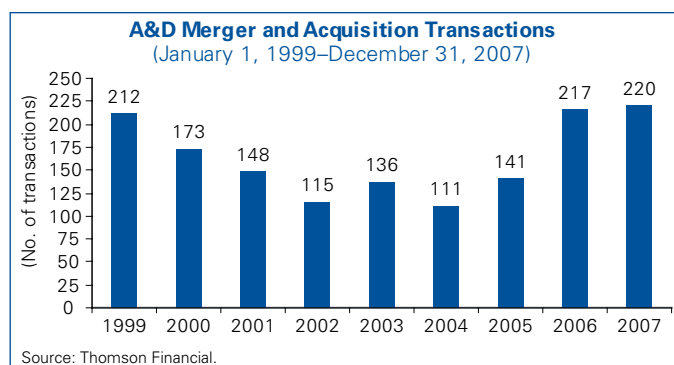
¹¹ Capital IQ.

Mergers and Acquisitions and Capital Market Updates

M&A activity continued to grow at a healthy pace in Q4 of 2007, surpassing Q3 results, and brought 2007's year end worldwide Aerospace and Defense announced deals to 220, surpassing 2006's high of 217 deals and 2001's 148 deals.⁹ With continued momentum from the last two quarters, we believe that the outlook for M&A activity in the sector continues to remain promising for 2008 as companies, notably international acquirers strengthened by favorable currency exchange, continue to utilize strong cash positions to aggressively seek growth through additional M&A.

Earnings Before Interest, Taxes, Depreciation, and Amortization (EBITDA) acquisition multiples have increased to their highest in eight years to 13.2x in 2007 from its previous high of 12.4x in 2005,¹⁰ possibly due to the continued performance of Aerospace and Defense stocks and strong growth in M&A activity in the sector.

In the capital markets, the S&P Aerospace and Defense Index ended the year up 17.5 percent, the S&P 500 up 3.7 percent, and the Dow Jones Industrial Average up 6.3 percent. In addition, the SPADE Defense Index ended the year up 21.6 percent in 2007, outperforming the S&P 500 for the seventh consecutive year.¹¹



Historical Transaction Multiples
(January 1, 1999 – December 31, 2007)

Year	EV/Sales	EV/EBITDA	Year	EV/Sales	EV/EBITDA
1999	1.18 x	7.09 x	2004	1.86 x	12.26 x
2000	1.08 x	7.86 x	2005	2.04 x	12.38 x
2001	1.11 x	8.31 x	2006	1.71 x	11.54 x
2002	0.90 x	10.67 x	2007	1.62 x	13.23 x
2003	1.76 x	11.11 x			

EV: Enterprise Value
EBITDA: Earnings Before Interest, Taxes, Depreciation, and Amortization
Source: Thomson Financial.

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2005	Number of Deals
1. KPMG Corporate Finance	429
2. Goldman Sachs	349
3. JP Morgan	325
4. PricewaterhouseCoopers	316
5. Morgan Stanley	315
6. Citigroup	313
7. UBS	270
8. Rothschild	258
9. Merrill Lynch	251
10. Credit Suisse	236

2006	Number of Deals
1. KPMG Corporate Finance	434
2. Goldman Sachs & Co	377
3. JP Morgan	334
4. Morgan Stanley	328
5. UBS	327
6. PricewaterhouseCoopers	317
7. Citigroup	314
8. Rothschild	309
9. Credit Suisse	275
10. Merrill Lynch	253

2007	Number of Deals
1. Citi	457
2. KPMG Corporate Finance	450
3. Goldman Sachs & Co	418
4. Morgan Stanley	395
5. UBS	392
6. JP Morgan	361
7. Credit Suisse First Boston	343
8. PricewaterhouseCoopers	335
9. Rothschild	329
10. Merrill Lynch	282

Source: Thomson Financial Securities. Each set of figures is taken from the league table press releases issued for that year.

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acted as financial adviser to
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