Q3 2010: Inside this Issue

Welcome to the most recent issue of Lincoln International's Aerospace and Defense ("A&D") Deal Reader, a newsletter focused on market dynamics, merger and acquisition trends and events of interest to owners and managers of global A&D businesses and their advisors.

Lincoln's Aerospace and Defense group is one of the largest and most active in the middle market - *and the only truly global team*.

In this issue, we are pleased to present a summary of the UK's Strategic Defense and Security Review ("SDSR"), a document outlining Britain's agenda for achieving its goals in defense, security, intelligence, resilience, development and foreign affairs capabilities over the course of the next decade.

Other topics covered in this issue include an article on the current trends in Washington D.C. by Lincoln Advisory Director Brigadier General Bob Edmonds, as well as a look at current market valuation statistics across the Aerospace & Defense Sector.

We hope you find this newsletter a useful tool, and welcome any comments.

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Commentary on the UK Strategic Defense and Security Review ("SDSR")

Prepared by Lincoln International's Teresa Clegg

Below is a summary of the key points outlined in Britain's SDSR, published October 19, 2010. Key background facts surrounding the SDSR include:

- *The last Strategic Defense Review took place in 1998 with the intervening Defense Industrial Strategy published in 2005*
- *In July 2009, the then Labour Government committed itself to undertaking a Strategic Defense and Security Review*
- *The review looks at how Britain's Armed Forces should be equipped to deal with current and future threats worldwide*
- *Suppliers await the UK Defense Industrial and Technological policy which will be published in final form in 2011 and details the Ministry of Defense's future approach to the UK defense industrial base*

The UK's long awaited SDSR held few shocks for defense suppliers: firstly, the cut of 8% over the next 5 years was less than expected; secondly, enough of the major themes had already come out in the press beforehand; and thirdly, personnel cuts (civilian and soldiers) will account for a good proportion of the savings. Most UK defense stocks increased a couple of percentage points upon the SDSR release.

With the exception of the Nimrod MRA4, no major platforms were cut. Instead, the UK government has determined to implement budget cuts through a mix of retirements, reductions and delays:

Royal Air Force jet in the Middle East

- Aircraft carrier Ark Royal to be retired in 2011, Illustrious in 2014
- New aircraft carriers will be procured but only one put in service, the second commissioning delayed
- Vanguard (Trident) replacement decision has been delayed
- F-35 order will be reduced and STOVL (Short Take Off and Vertical Landing) replaced with carrier variant
- Harrier fleet retired from 2011
- Challenger tanks fleet - 40% to be retired
- AS 90 artillery vehicle – 35% to be retired
- Tornado fleet will be reduced
- Surface fleet of frigates and destroyers will be reduced from 23 ships to 19

Increased commitments to cyber warfare are intended as expected. The industry expressed relief as a number of high profile programs were left unscathed including the A400M, Eurofighter, Astute, FRES (Future Rapid Effect System) and FSTA (Future Strategic Tanker Aircraft).

Community views on the SDSR:

"Having supported the review of the UK's defense acquisition system in 2009, we were not surprised by the overall shape of the outcome, and the emphasis on prevention and deterrent power. Given the cost pressures, it will mean that both front line and manufacturing supply chains will have to continue to drive for efficiency gains. On another point, we would have hoped for greater investment in unmanned vehicles in the portfolio".

– *Peter Debenham, Partner, L.E.K. Consulting*

"The UK's decision to move from STOVL F-35B JSF to the carrier F-35C JSF version is likely to have major industrial implications across the UK supply chain…militarily, the decision may be sound (carrier version has more payload and range) but the STOVL version played to UK strengths."

– *George Burton, Director, Counterpoint Market Intelligence*

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General's Mission Briefing

Brigadier General Bob Edmonds

USAF, retired

Brigadier General Bob Edmonds is an Advisory Director in Lincoln International's Aerospace and Defense Group. He retired in 2007 from the United States Air Force after 28 years of service, including as an F-15 pilot and commander. His experience also includes leading the U.S. Air Force's Senate Liaison office on Capitol Hill after September 11, 2001 and serving as a White House Fellow.

It's still all about the budget…and about Efficiency and Affordability

It bears repeating from last quarter's DealReader: with continuing concerns about deficit spending and mounting debt, the focus in industry is on the Federal budget – as it should be. This current economic situation is the biggest threat to our national security.

Following up on the DoD budget from last quarter:

- Secretary Gates has issued an order to **cut $101.9 billion from Pentagon spending over the next five years** (Program Objective Memorandum 2012-2016) leading into an era of "Efficiency and Affordability"
- Secretary Gates is getting ahead on the Pentagon budget because he can see it's only a matter of time before OMB (the Office of Management and Budget) comes after it to pay for other Administration priorities: "**the gusher of money will be capped**"
- Affordability is the new buzz word inside the Pentagon, meaning affordable programs with minimal technology risk
- The much talked about cost-cutting memo from Pentagon Acquisition Chief Dr. Ashton Carter (issued Sept. 14), titled "….greater efficiency and productivity in defense spending," is a follow-on to his summit address last quarter, with some of the document's key elements including:
  - ***Mandate affordability as a requirement.*** Program managers now have to set an Affordability Target early that cannot be changed without Carter's approval
  - ***Drive productivity through "should cost" management.*** Executing to what a program "should cost," not what it "will cost"
  - ***Eliminate redundancy within warfighter portfolios.*** In all the Services – Army has done so first – will do Portfolio Reviews; expect more program cuts in the FY2012 budget
  - ***Incentivize productivity and innovation in industry.*** Reward companies for supply chain and indirect expense management; increase use of Fixed Price Incentive Firm target contract types
  - ***Present a competitive strategy at every milestone.*** Promoting real competition to drive down costs – could open the door to more companies participating

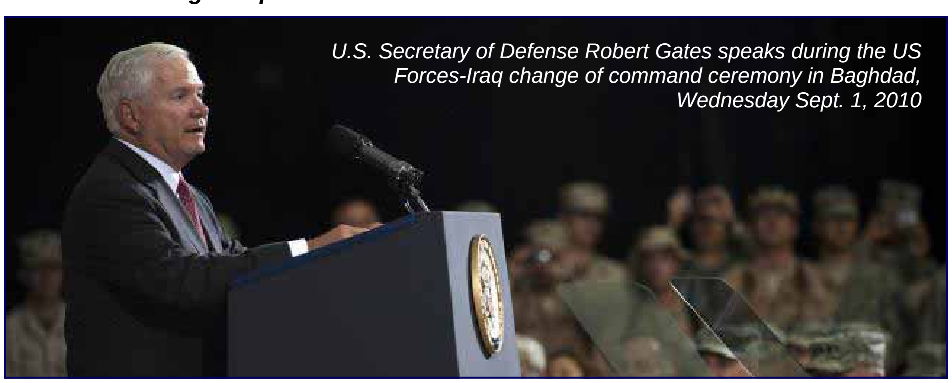
These are turbulent times in the A&D market place – some implications of the budget woes:

- **Fewer new, large starts in upcoming programs** – procurement budgets squeezed; new Affordability focus on large (in DoD terms, ACAT 1) programs will drive the Services to avoid these large programs for ones below the threshold
- **Accordingly, more medium and small programs** – key will be to use these as stepping stones to new markets, new customers, and to introduce new technologies / products
- **Increased emphasis on retaining current programs** – pay attention to the work on contract, execution performance, and opportunities to provide more value. ***This will be a key element in valuing companies for M&A***
- **Significant risk has shifted to contractors** with recent acquisition policy and implementation changes
- **Industry has been forced to take on even more cost cutting** to meet DoD direction and survive during the weak economy – overhead and indirect costs must be reduced
- With federal budget issues, shifting priorities in government, and the initial winding down in Afghanistan, **the government departments and agencies are in flux** – difficult for industry to clearly understand / meet requirements

Not all is "doom and gloom" for future spending. As I have stated in previous columns, funding will continue to be strong in **ISR technologies, Unmanned Aerial Systems, Net Centric and Cyber warfare** capabilities. A couple of thoughts for investment professionals:

- All about Net Centricity – integration of multiple platforms / technologies
- Find companies in the C5ISR area: focus not on the platforms, but rather on the outcome and the results – it's about decision-quality knowledge
- Start looking for new buzz words: operational responsive ISR – it's not about the domain, but rather it's about the information...or decision-quality knowledge which needs common interfaces, control systems, data compression and storage products
- Products and technologies which will be most attractive are ones with built-in flexibility, versatility, and efficiency
- Improvement in energy efficiency, endurance, power consumption, and miniaturization of products

Election flash: the Republican take over of the House will not change much. There are still great pressures from both sides on reducing spending...it's still all about the budget!



U.S. Secretary of Defense Robert Gates speaks during the US Forces-Iraq change of command ceremony in Baghdad, Wednesday Sept. 1, 2010

Public Trading Statistics

	Stock Price	52 Week High	52 Week Low	Enterprise Value	1-Year Growth Revenue	1-Year Growth EBITDA	EV / LTM Revenue	EV / LTM EBITDA
Large Cap								
BAE Systems plc	$5.66	$6.25	$4.62	$20,590	14.9%	73.4%	0.6x	4.3x
Boeing Co.	70.48	76.00	47.33	54,311	4.3%	355.5%	0.8x	7.7x
EADS	26.56	27.36	15.89	15,163	(1.8%)	(85.7%)	0.3x	20.0x
General Dynamics Corp.	67.86	79.00	55.46	26,995	(0.5%)	4.5%	0.8x	6.2x
Goodrich Corp.	82.17	82.98	53.89	11,619	1.0%	0.7%	1.7x	9.4x
Honeywell International Inc.	46.80	48.63	35.60	40,705	2.7%	(3.2%)	1.3x	9.9x
Lockheed Martin Corporation	71.47	87.19	67.87	27,334	8.1%	0.9%	0.6x	5.4x
Northrop Grumman Corporation	63.51	69.80	49.63	20,164	8.2%	10.0%	0.6x	5.5x
Precision Castparts Corp.	137.17	141.21	93.00	19,480	(1.5%)	(1.9%)	3.4x	12.2x
Raytheon Co.	46.90	60.10	42.65	17,401	2.7%	(8.7%)	0.7x	5.9x
Rolls Royce Group plc	10.49	10.61	6.97	17,452	5.1%	0.9%	1.0x	8.8x
Safran SA	32.47	33.18	14.87	14,826	(0.1%)	(0.5%)	1.0x	7.8x
United Technologies Corp.	74.64	77.09	61.43	76,811	0.2%	20.8%	1.4x	8.0x
Mid Cap								
Bombardier, Inc.	$4.97	$6.15	$4.19	$10,746	(5.9%)	(15.9%)	0.6x	7.3x
CAE Inc.	11.36	11.55	8.22	3,207	(8.7%)	(13.1%)	2.1x	9.3x
Cobham plc	3.77	4.47	3.30	4,947	5.9%	18.7%	1.6x	7.7x
Elbit Systems Ltd.	54.03	69.67	51.66	2,471	(3.1%)	(17.7%)	0.9x	7.3x
Finmeccanica SpA	13.81	16.75	10.71	15,654	6.9%	(0.3%)	0.6x	5.9x
GKN plc	2.85	3.02	1.64	5,332	12.7%	88.1%	0.7x	7.2x
L-3 Communications Holdings Inc.	72.69	97.81	66.11	11,893	1.4%	6.6%	0.8x	6.1x
Meggitt plc	5.36	5.40	3.70	5,089	(8.9%)	1.0%	2.8x	11.2x
Rheinmetall AG	72.99	76.38	49.09	3,293	4.5%	78.9%	0.6x	6.4x
Singapore Technologies Engineering Ltd.	2.64	2.65	2.18	7,839	4.5%	15.9%	1.8x	14.2x
Thales	41.03	49.92	34.71	9,072	2.8%	(27.4%)	0.5x	10.9x
Triumph Group, Inc.	83.27	84.59	46.17	3,316	12.1%	13.9%	2.4x	14.7x
Ultra Electronics Holdings plc	30.36	30.41	19.22	2,111	11.1%	9.8%	1.9x	11.7x
Zodiac Aerospace SA	72.36	74.16	30.86	4,733	(3.4%)	(15.3%)	1.6x	13.4x
Small Cap								
Cohort PLC	$1.34	$2.65	$0.91	$50	1.8%	(20.9%)	0.4x	6.3x
LMI Aerospace Inc.	15.57	19.50	10.53	188	(4.3%)	(8.1%)	0.8x	6.5x
Magellan Aerospace Corp.	2.68	3.20	1.19	282	(2.9%)	(13.4%)	0.4x	4.1x
OHB Technology AG	18.21	25.46	11.90	259	36.8%	23.4%	0.5x	6.3x
QinetiQ Group Plc	1.78	2.87	1.54	1,925	0.5%	(20.4%)	0.7x	7.4x
Senior plc	2.10	2.40	0.91	981	(1.2%)	6.0%	1.1x	7.3x
Teledyne Technologies Inc.	41.61	44.57	32.95	1,751	0.2%	10.3%	1.0x	7.9x
UMECO plc	7.00	7.30	4.10	466	(0.4%)	(4.3%)	0.7x	8.0x

Notes:
1. Data as of market close on 11/5/2010
2. All figures: USD in millions; sorted by Market Capitalization

Select Recent Industry Transactions

- 10/25/2010: **BE Aerospace Inc. (Nasdaq:BEAV)** announces the acquisition of **Satair A/S's Aerospace Fastener Distribution Business**, a distributor of aircraft interior parts and accessories to European and Asia Pacific aerospace manufacturers and their suppliers.
- 10/18/2010: **CACI International (NYSE:CACI)** announces the acquisition of **TechniGraphics, Inc.**, a provider of digital mapping and computer-automated design services to engineering and global information systems customers.
- 10/13/2010: **Veritas Capital** announces the acquisition of **Lockheed Martin's Enterprise Integration Group**, a provider of mission-critical systems engineering and integration services and modeling, simulation, analysis and risk mitigation services to the U.S. intelligence community.
- 10/12/2010: **Kaiser Aluminum Corporation (Nsadaq:KALU)** announces the acquisition of **ALEXCO LLC**, a manufacturer of hard allow aluminum extrusions for the aerospace industry.
- 10/4/2010: **BE Aerospace Inc. (Nasdaq:BEAV)** announces the acquisition of **TSI Group, Inc.**, a provider of electronic, thermal management, interconnect, and mechanical assemblies and components for aerospace and defense applications.
- 9/30/2010: **ManTech International Corporation (Nasdaq:MANT)** announces the acquisition of **QinetiQ North America's Security and Intelligence Solutions (S&IS) business**, a provider of integrated security solutions to the Department of Defense and the intelligence community.
- 9/30/2010: **Indaer International** announces the acquisition of **Avcraft Support Services, Inc.**, a provider of Maintenance, Repair and Overhaul ("MRO") services to the commercial aerospace sector.
- 9/29/2010: **Diamondback Tactical, LLLP** announces the acquisition of **First Choice Armor and Equipment, Inc.**, a manufacturer of body armor protection products for law enforcement, military and homeland security applications.
- 9/29/2010: **Management of Satori SAS,** backed by a French private equity fund, announces the acquisition of **Satori SAS** from **Cobham plc (LSE:COB)**, a provider of MRO services for aircraft components and equipment.
- 9/29/2010: **Six3 Systems Inc.** announces the acquisition of **Novii Design, LLC**, a provider of large scale data fusion systems, cyber solutions and high-end enterprise architectures to the Intelligence Community.

Recent Lincoln International Closed Transactions in Aerospace and Defense

CIPHENT
has been acquired by
ACCUVANT
a portfolio company of
SVERICA INTERNATIONAL

COBHAM
has disposed
SATORI
to management, backed by a French private equity fund

September 17, 2010
Lincoln International advised Ciphent Inc. ("Ciphent") in its sale to Accuvant Inc., a portfolio company of Sverica International. Ciphent is a leading provider of cyber security solutions for major government agencies including the U.S. military and intelligence community, as well as commercial organizations spanning the Fortune 100 list and hundreds of middle market companies.

September 29, 2010
Lincoln International advised Management of Satori SAS, backed by a French private equity fund, in its acquisition of Satori SAS from Cobham plc (LSE:COB). Satori SAS provides MRO services on a range of third party components and equipment.

About Lincoln International

Lincoln International specializes in merger and acquisition advisory services, private capital raising and restructuring advice on mid-market transactions. Lincoln International also provides fairness opinions, valuations and pension advisory services on a wide range of transaction sizes. With ten offices in Asia, Europe and North America, and strategic partnerships with leading institutions in China and India, Lincoln International has strong local knowledge and contacts in the key global economies. The organization provides clients with senior-level attention, in-depth industry expertise and integrated resources. By being focused and independent, Lincoln International serves its clients without conflicts of interest. More information about Lincoln International can be obtained at www.lincolninternational.com.

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- Building and Infrastructure
- Business Services
- Chemicals
- Consumer
- Food and Beverage
- Healthcare
- Industrials
- Paper & Packaging
- Renewable Energy
- Transportation and Logistics

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