

Holding steady 2010 Midyear outlook for the global aerospace and defense sector



“The industry is holding its own with flat performance so far this year. There is reason for cautious optimism on the commercial side and concern in the defense segment due to a decreasing spending outlook.”

— Tom Captain, Global Aerospace & Defense Sector Leader,
Deloitte Touche Tohmatsu (DTT) Global Manufacturing Industry Group

2010 is expected to be flat

After a record-setting five-year run ended in 2008, last year's sector performance was off its peak. Sales in 2009 were essentially flat with a small 1.3% increase, while earnings were down 15.3% from 2008.¹ If not for the large program related write-offs, asset impairments, or regulatory fines² at a few of the largest firms, industry profits would have been essentially flat as well. This financial performance could be viewed as positive when compared to the significant negative economic impact of the global recession. The industry continues to demonstrate its resiliency in the face of uncertain economic conditions.

¹ “2009 Global Aerospace & Defense Industry Performance Wrap-up,” Deloitte Development LLC, 11 May 2010.

² “Managing cross-border legal and regulatory risks in aerospace and defense,” Lexology, 7 April 2010.

The global aerospace and defense (A&D) industry as of midyear 2010 is experiencing the same “flat” financial performance that was seen in 2009, although results varied widely by individual companies. For the top 25 global A&D firms that have issued quarterly financial statements thus far in calendar 2010 as a group, sales revenue growth was -1.01%, operating profits were -1.94%, and operating margins were -0.94% (see Figure 1). Holding steady on these key financial performance metrics indicates that the global industry has largely held up to the continued downward pressure on defense spending, managed its way through difficult and large-scale product introductions, and experienced continued slow sales in the commercial aircraft and business jet segments.

Military equipment spending, led by the U.S. Department of Defense (DoD), is declining with several significant weapon system programs terminated in 2009 and an expectation that more cuts will be forthcoming. The Pentagon has requested a US\$549 billion base budget for fiscal year (FY)2011, only a 1.8% increase over FY2010, in which the budget grew by 2.1%. These budgets may appear paltry to defense contractors after eight years of robust 4% average annual growth and probably not enough to keep up with inflation.³

On the upside, air traffic growth has slowly returned and business jet sales forecasts are looking more optimistic.⁴ Commercial aircraft production rate increases announced thus far in 2010 are a positive signal especially for suppliers going forward.

At the midpoint of 2010, key questions on the minds of many industry executives and shareholders include:

1. How will the commercial aircraft segment sustain profitable growth in a flat production environment?
2. How will defense companies deal with the expected slowdown in military research and development (R&D) and large platform program starts?

Commercial aircraft

Figure 1: Top 25 global A&D companies' first quarter 2010 versus first quarter 2009

| Company | Quarterly revenue year-over-year (YoY) % change | Quarterly operating profit YoY % change | Quarterly operating margin YoY % change |
|-----------------------|---|---|---|
| Boeing | -7.79% | 14.54% | 24.22% |
| EADS | 5.70% | -64.22% | -66.15% |
| Lockheed Martin | 2.55% | -7.10% | -9.40% |
| Northrop Grumman | 8.51% | 23.59% | 13.90% |
| General Dynamics | -6.22% | 1.44% | 8.16% |
| Raytheon | 2.87% | -0.42% | -3.20% |
| Finmeccanica | 3.27% | 5.56% | 2.21% |
| United Technologies* | 9.10% | 35.99% | 24.65% |
| GE Aviation* | -13.54% | -26.02% | -14.44% |
| L3 Communication | -0.33% | 9.04% | 9.40% |
| Thales | 7.64% | NA | NA |
| Safran | -2.45% | NA | NA |
| SAIC | 1.36% | 1.47% | 0.11% |
| Honeywell Aerospace* | -9.17% | -15.37% | -6.82% |
| Textron | -12.51% | -73.17% | -69.33% |
| Mitsubishi Aerospace* | -4.17% | -25.00% | -30.43% |
| Bombardier Aerospace* | -12.80% | -19.09% | -7.22% |
| Goodrich | -0.04% | -17.48% | -17.44% |
| ITT Defense* | -3.85% | -11.14% | -7.58% |
| Harris | 10.32% | 24.33% | 12.70% |
| KBR* | -30.12% | -45.88% | -22.56% |
| Alliant TechSystems | -0.64% | 203.04% | 204.97% |
| Rockwell Collins | 0.35% | -18.33% | -18.62% |
| Dassault Aviation | 50.44% | NA | NA |
| Embraer | -14.21% | 110.26% | 145.08% |
| TOTAL | -1.01% | -1.94% | -0.94% |

*Partial company results based on A&D activities.

Source: DTT Global Manufacturing Group analysis from the first quarter 2010 data for the U.S. companies and analogous documents for the European companies.

Note: The above companies represent the largest A&D companies (based on 2009 annual data) for which quarterly revenue figures are available. The data reflect the most recent quarter for each company.

³ “Weapons Budget Grows Amid Obama Cuts,” Bloomberg, 6 July 2010.

⁴ “International Air-Passenger Traffic Jumps in May,” Wall Street Journal, 29 June 2010 and “Forecasts 2010: Business aviation on the rise?” Flight Global, 4 April 2010.

After about a 15-year low in sales orders in 2009 of large commercial aircraft, the industry is increasing its sales order rate again and the forecast is a return to long-term compounded growth rates between 4.5% to 5% in air traffic. The demand for aircraft is being driven by this increase in passenger demand for air travel, more fuel efficient aircraft, and overall growth in end markets, particularly in underserved markets such as China, India, and the Middle East. Through April 2010, global revenue passenger kilometer (RPK) growth has increased by 5.8% year to date (YTD). The Middle East region has demonstrated the highest growth rate in RPKs with a 21.7% increase YTD (see Figure 2). In addition, efficiency of aircraft use has increased with percentage of seats occupied (passenger load factor or PLF) at 76.7% as of midyear, although this varies by geographic region.

In addition, air freight traffic has returned to growth after a prolonged period of steep declines associated with the global recession. Growth in FTK has increased 26.9% YTD, which illustrates a growing global economy, although results vary by geographic region. Figure 2 illustrates the growth in passenger and freight demand so far in 2010.

Figure 2: Growth in global demand for air traffic

| YTD April 30, 2010 versus YTD 2009 | RPK growth | Available seat kilometers (ASK) growth | PLF | Freight ton kilometers (FTK) growth | Available ton kilometers (ATK) growth |
|------------------------------------|-------------|--|-------------|-------------------------------------|---------------------------------------|
| Africa | 11.1% | 8.1% | 68.0 | 43.8% | 10.9% |
| Asia Pacific | 8.7% | -0.4% | 78.2 | 35.5% | 11.8% |
| Europe | 0.0% | -3.5% | 76.2 | 9.4% | -8.0% |
| Latin America | 6.5% | 1.2% | 75.7 | 46.0% | 23.3% |
| Middle East | 21.7% | 14.0% | 75.3 | 31.9% | 15.4% |
| North America | 3.2% | -2.3% | 78.9 | 27.5% | -3.1% |
| Industry | 5.8% | -0.1% | 76.7 | 26.9% | 3.9% |

Source: International Air Transport Association, Economics, April 2010.

A return to growth for leisure and business travel, coupled with growth in freight traffic has resulted in positive growth in sales of commercial passenger and freight aircraft. Indeed, YTD through May 2010, aircraft sales at Boeing and Airbus have increased 114% and 153%, respectively, albeit from a low sales base in 2009.⁵ Figure 3 summarizes the orders, cancellations, and growth rates for Boeing and Airbus.

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Figure 3: 2010 Summary of commercial aircraft orders and comparison to 2009

| | Boeing May YTD | | | | Airbus May YTD | | | |
|---------------------------|----------------|------------|-------------|---------------|----------------|-----------|-------------|---------------|
| | 2009 | 2010 | Change | Cancellations | 2009 | 2010 | Change | Cancellations |
| Narrowbody | 42 | 76 | 81% | 5 | 15 | 28 | 87% | 8 |
| Widebody | 23 | 63 | 174% | 23 | 17 | 53 | 212% | 0 |
| Total gross orders | 65 | 139 | 114% | 28 | 32 | 81 | 153% | 8 |

Source: "Commercial Aerospace Industry Update," D.A. Davidson & Co., 17 June 2010.

⁵ "Commercial Aerospace Industry Update," D.A. Davidson & Co., 17 June 2010 and DTT Global Manufacturing Industry Group analysis.

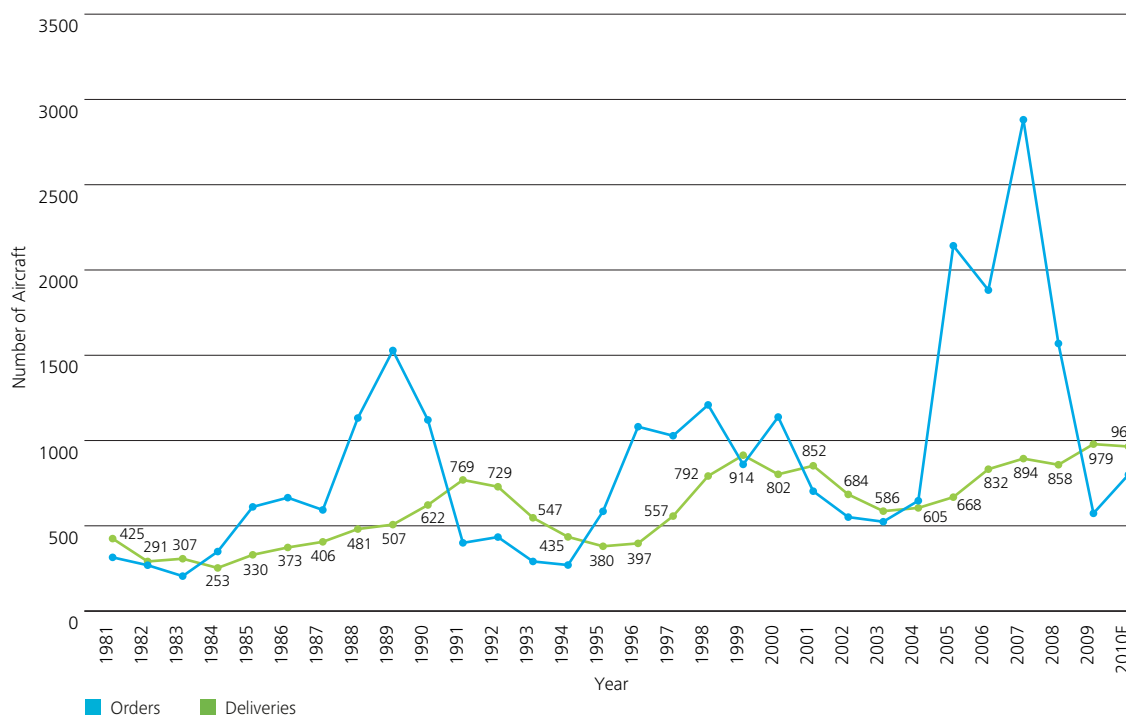
The growth rates in orders for commercial aircraft seen thus far in 2010 are beginning to be in line with expectations for a recovery to long-term growth trends in aircraft orders. Should the recovery continue into the second half of 2010, total orders for commercial aircraft is expected to be in the 800 unit range for 2010 — a level still below the anticipated levels of orders to coincide with long-range forecasts for aircraft to be produced over the next 20 years.⁶

As seen in Figure 4, long-term growth in aircraft production is expected to increase due to global trends, including significant increases in wealth in developing countries in the Asia-Pacific region, replacement of older aircraft in favor of modern fuel-efficient and

environmentally-friendly aircraft, new point-to-point markets, and underserved geographies being opened. Although 2009 was a year of a global economic recession, the large commercial aircraft producers delivered 979 aircraft to global operators, an all time record.⁷ Suppliers to the commercial aircraft business have found some comfort that the backlog as of May stands at a little over 6,600 aircraft yet to be produced, representing over six years of work locked in.⁸

Figure 4 illustrates the longer-term history of aircraft deliveries compared to aircraft orders, as well as the forecast, which demonstrates the long-term growth pattern and resiliency that can be expected.

Figure 4: Commercial aircraft production and gross sales orders: 1981-2010E(estimate)



Source: DTT Global Manufacturing Industry Group analysis.

⁶ DTT Global Manufacturing Industry Group analysis.

⁷ "Commercial Aerospace Industry Update," D.A. Davidson & Co., 17 June 2010 and DTT Global Manufacturing Industry Group analysis.

⁸ "Boeing Commercial Airplanes presentation," The Boeing Company, June 2009.

The market demand for new large-scale commercial aircraft is forecasted to be almost 30,000 new commercial aircraft through 2029, worth an estimated \$3.2 trillion.⁹ With 16% of the backlog dedicated to the Asia-Pacific region, it is quickly becoming the largest market for new orders.¹⁰ In 20 years, 83% of the fleet flying at that time is expected to be new fuel-efficient, more comfortable, and green aircraft, placed in service after 2008.¹¹

The demand for new large-scale commercial aircraft has caught the attention of several new potential entrants into the current duopoly. Canadian, Chinese, and potentially Brazilian competitors may emerge to become the third major supplier to the world's aircraft operators. Thus, the long-term outlook for air travel and the resultant increased sales and production of new aircraft remains optimistic, despite the short-term industry challenges.

As we close out the first half of 2010, the commercial aircraft segment appears to be at the beginning of the next up-cycle. Announcements of increased production rates, continued longer-term forecasts for increased sales orders, and a global economy that demonstrates the need for business and leisure travel, as well as delivery of goods around the world should provide cautious optimism to suppliers. Commercial aircraft producers in the slower near-term sales order environment should expect a return to positive growth rates in revenues and earnings as the rates of production continue to increase over the mid and longer term.

General and business aviation

After a tumultuous 2009 with record production cuts, layoffs, and a precipitous fall off of new sales orders, business jet producers and their suppliers can expect a small uptick, albeit tentative, as corporations are utilizing their business aircraft at an increased rate.¹² General aviation and personal business jet usage has increased slightly, and there is a sense of cautious optimism for a market bottom in 2010 and a return to growth in the midterm. Pratt & Whitney Canada, the world's biggest maker of small and medium business-jet engines, projects its market will return to peak production levels by 2015 and plans to pursue orders from makers of larger planes.¹³

In 2010, piston deliveries experienced a 7.3% decrease in shipments, where only 166 piston aircraft were delivered, signalling a bottoming out of the free fall experienced last year (see Figure 5). In contrast, the entire piston sector in the previous five consecutive years had delivered at least 2,000 aircraft. Compared to two years ago (first quarter of 2007), this represents a 70% decrease, demonstrating the deep impact the sector has felt from the recession.¹⁴

Figure 5: First quarter 2010 shipments of business and general aviation aircraft manufactured worldwide

| Product | 2009 | 2010 | Change |
|------------------------|----------------|----------------|---------------|
| Pistons | 179 | 166 | -7.3% |
| Turboprops | 92 | 60 | -34.8% |
| Business jets | 191 | 164 | -14.1% |
| Total shipments | 462 | 390 | -15.6% |
| Total billings | \$4.34B | \$4.64B | +6.9% |

Source: "General Aviation Airplane Shipment Report," General Aviation Manufacturers Association (GAMA), 7 May 2010.

Piston aircraft manufacturers anticipate the bottom of the cycle is now and expect to post a slight improvement in deliveries for the entire year. A handful of manufacturers have already increased production, signalling an ascent from the bottom of the cycle. A full recovery could take several years for the industry to return to its 2006 peak, when 2,755 piston aircraft were delivered.¹⁵

Improvements in the availability of financing, which was one of the sector's major challenges last year, and the recovering stock market are giving prospective buyers more capacity to purchase general aviation aircraft. Aircraft producers indicate this is a positive trend that even six months ago did not exist.

In summary for the first half of 2010, the general and business aviation segment is still reeling from the most significant downturn in its history. However, there are signs that the bottom has been reached, and that buyers are returning to the market. In addition, new markets in Russia, the Middle East, and China continue to be opportunities for business jet and general aviation producers, which was all but suspended during the economic crisis.

⁹ "Current market focus: 2009–2028," The Boeing Company, Copyright 2009.

¹⁰ "Current market focus: 2009–2028," The Boeing Company, Copyright 2009.

¹¹ "Current market focus: 2009–2028," The Boeing Company, Copyright 2009.

¹² "Throttling back: Midyear outlooks for the global aerospace and defense industry," Deloitte Touche Tohmatsu, 17 June 2009.

¹³ "Business-Jet Engine Sales to Return to Peak by 2015 Pratt & Whitney Says," Bloomberg, 15 June 2010.

¹⁴ "General Aviation Airplane Shipment Report," GAMA, 7 May 2010.

¹⁵ "Recovery slowly begins for battered piston market," Flight global, 15 June 2010.

China in particular represents a large opportunity in the midterm as import duties have been moderated, flight planning regulations are being relaxed, and landing fees have become more affordable.

Defense

Defense budgets, particularly in the U.S. and Europe are under great pressure for reductions, in favor of other domestic government spending priorities. As of press time, budgets in the developed Western world are flattening and even decreasing. However, when viewed from the perspective of the “addressable spend” — that which is available to defense contractors for R&D and for procurement of weapons platforms — these budgets are expected to fall from previous levels.

In the United States, which constitutes approximately 45.8%¹⁶ of the world’s defense budget, the President’s defense budget for 2011 is proposed at US\$712.1 billion, for a 7.2% nominal increase from fiscal year FY2009 to FY2011 (see Figure 6). However, an ever-increasing amount of the budgets in the last three years have gone to increased military pay, increases in the operations and maintenance (O&M) accounts, medical care for the wounded warrior programs, and inflation — leaving a smaller slice of the budget for the R&D and procurement accounts. In particular, research, development, test, and evaluation (RDT&E), accounts for the proposed FY11 budget show a 5% decline in spending, with a 7.7% increase in procurement accounts, mostly from programs of record, not new starts. Figure 6 shows the U.S. DoD budget trends in these accounts.

New program starts globally for large-scale platforms, such as fighter aircraft, naval vessels, and reconnaissance aircraft are decreasing significantly. This trend requires defense companies to ensure success in head-to-head selection battles creating “must win” competitions. As a result and widely reported regarding the U.S. Air Force air refueling tanker replacement program,¹⁷ the stakes are high with protests in source selection becoming commonplace which has slowed the program execution process. With the delay in new program starts, some companies may elect to exit portions of the business and others may merge or consolidate business lines.

Some programs of record may be terminated due to cost and schedule overruns or determinations may be made that certain weapons programs conceived to fight the Cold War are no longer necessary. Conversely, programs that can be developed and fielded quickly to address the type of irregular warfare with insurgents and invisible adversaries are becoming more frequent and may attract funding.

For defense contractors, new areas will generate growth in 2010 and beyond. In particular, the number and variety of large hardware-based platforms is expected to decline and more innovation and capability will be found in software integration. Mission capability will increasingly be created by information technology services firms, which are well poised to create competitive advantage through innovation in battle space simulation, directed energy, precision engagement, threat identification, as well as energy and infrastructure security.

Figure 6: U.S. defense budget authority (US\$ millions)

| Department | FY07 | FY08 | FY09 | FY10 | FY11 | % change FY10-11 | Compound annual growth rate |
|---------------------------------|------------------|------------------|------------------|------------------|------------------|------------------|-----------------------------|
| Military personnel | \$112,861 | \$119,895 | \$129,370 | \$139,483 | \$143,524 | 2.9% | 6.2% |
| O&M | \$148,559 | \$162,874 | \$181,093 | \$185,121 | \$200,875 | 8.5% | 7.8% |
| RDT&E | \$76,042 | \$77,959 | \$78,784 | \$80,098 | \$76,131 | -5.0% | 0.0% |
| Procurement | \$84,001 | \$99,137 | \$100,339 | \$104,799 | \$112,873 | 7.7% | 7.7% |
| Military construction | \$9,155 | \$17,830 | \$23,946 | \$21,021 | \$16,924 | -19.5% | 16.6% |
| Oversees contingency operations | \$167,794 | \$186,908 | \$150,441 | \$129,646 | \$159,336 | 22.9% | -1.3% |
| Other | \$3,835 | \$8,884 | \$551 | \$3,167 | \$2,467 | -22.1% | -10.4% |
| Total budget authority | \$602,247 | \$673,487 | \$664,524 | \$663,335 | \$712,130 | 7.4% | 4.3% |

Note: FY07–FY09 actuals. FY10 estimated. FY11 proposed.

Source: “Financial Summary Table,” U.S. Department of Defense, February 2010.

¹⁶ Note: Calculation was based on global defense budget figure from 2008 Stockholm International Peace Research Institute report and U.S. DoD FY08 defense budget (see Figure 8).

¹⁷ “The USAF’s KC-X Aerial Tanker RFP,” Defense Industry Daily, 10 May 2010.

“Decreasing defense spend by developed countries will require smarter use of the remaining funds in order to develop and deploy the technologies needed to counter our ever more sophisticated adversaries.”

— *General (United States Air Force retired) Charles Wald, Director and Senior Advisor, Aerospace & Defense Industry Sector, Deloitte United States (Deloitte LLP)*

In certain countries, in particular India and the Middle East, the picture is quite different. India’s defense spending is growing significantly and at an unprecedented rate. These geographies are emerging as a key participant in the Asia-Pacific region. United States and European aerospace companies are now recognizing India as a critical market, as well as a potential engineering and manufacturing partner. It is becoming one of the largest military spenders in the world, with the third-largest defense procurement budget in Asia. In 2010–11, US\$32 billion has been earmarked for national defense. Of this, US\$13 billion is to be spent on acquisitions for new weapons systems equipment and services.¹⁸

It is estimated that Indian defense procurement will rise to an estimated US\$42 billion by 2015, including US\$19.2 billion for capital acquisitions, which makes it one of the most attractive defense markets in the world. In total, India is expected to spend nearly US\$100 billion on military procurement during the current five-year plan (2007–12) and US\$120 billion in the following five-year plan period (2012–17).¹⁹ There are greater opportunities for the Indian defense industry to work in collaboration with traditional defense companies, thus enabling them to have broader market access. Figure 7 illustrates expected expenditures by armed service units by year through 2015.

Figure 7: India’s projected expenditure by each service division (US\$ million)

| | 2010–11 | 2011–12 | 2012–13 | 2013–14 | 2014–15 | Total 2011–2015 |
|---------------------|----------|----------|----------|----------|----------|-----------------|
| Capital expenditure | \$13,110 | \$14,421 | \$15,863 | \$17,450 | \$19,195 | \$80,039 |
| Army (53%) | \$6,948 | \$7,643 | \$8,407 | \$9,249 | \$10,173 | \$42,421 |
| Navy (16%) | \$2,098 | \$2,307 | \$2,538 | \$2,792 | \$3,072 | \$12,806 |
| Air Force (31%) | \$4,064 | \$4,471 | \$4,918 | \$5,410 | \$5,950 | \$24,812 |

Source: Indian Thirteenth Finance Commission Report, December 2009. Union Budget(s) & Economic Survey 2003-2011. DTT Global Manufacturing Industry Group analysis of allocations by service division.

^{18 and 19} “Prospects for Global Defence Export Industry in Indian Defense Market,” Deloitte Touche Tohmatsu India Private Limited, 16 June 2010.

Defense spending upsides

Defense spending is subject to current global events, which are unpredictable. As a result, any number of wildcard catalysts and uncertainties may ignite new defense spending, with the velocity and direction of that spending dependent on the particular threat faced. This includes the rapidly maturing nuclear threat in Iran and instability in Pakistan. North Korea's continued long-range strike and nuclear-arms development continues to pose a threat to regional stability.

Additional wild cards and potential scenarios include eruptions of low-level tensions between the U.S. and Russia over buffer states (Georgia, Ukraine, and Kazakhstan), piracy in commercial shipping lanes off the coast of Somalia and in the Malacca Straights, and Chinese policy shifts on Taiwan. Tensions between India and Pakistan have yielded problems in recent years and could potentially flare as well. The ambitions for military technology development and deployment by China in the South China Seas are cause for some alarm. However, given the codependency of the Western nations and China, it would be difficult to imagine a first strike by China with the incredible damage it could cause to the Chinese economy.

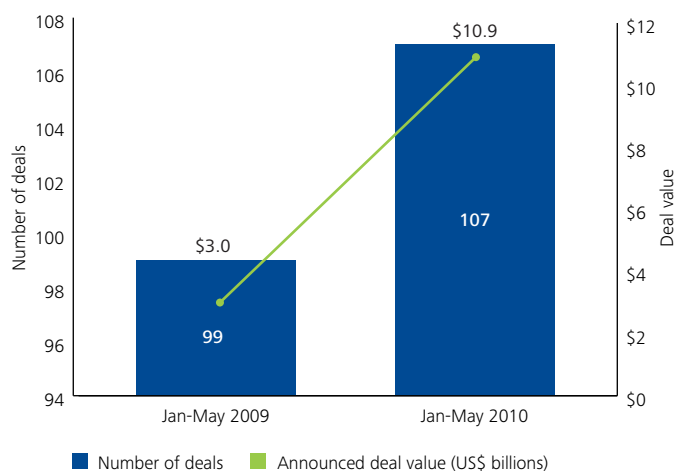
Furthermore, there are two other significant reasons for financial optimism among defense contractors. Firstly, the average age of global air force fighters, tankers, reconnaissance, and patrol aircraft inventories are increasing, and the equipment is more expensive to maintain and to operate. For example, the United States Air Force fleet in 2008 was 24 years old. There are instances where the air services are relying on aircraft that are over fifty-years old.²⁰ This equipment will need to be replaced eventually, some sooner than expected. Secondly, over the long term, defense will be an innovator of technology for the sector. In the past, technology such as GPS developed for military use has made its way into broader commercial and consumer markets. We expect that the historic innovations developed by the global A&D industry will continue to provide opportunities and drive financial success.

Mergers and acquisitions

Merger and acquisition (M&A) activity has been accelerating over the last several months. Larger transactions include: acquisition by Kohlberg Kravis Roberts & Co. and General Atlantic Partners of the TASC business unit divested by Northrop Grumman, the pending sale of DynCorp to Cerberus, the acquisition of VT Group plc by Babcock International Group plc, and the sale of Vought by Carlyle to Triumph Group. M&A activity has increased by 8% thus far in 2010 from prior-year levels, as measured by deal size (see Figure 8).

M&A activity in 2009 was up significantly with a 10% rise in the number of deals announced and a 300+% increase in the value of those deals. The Figure 8 shows the deals completed and pending.

Figure 8: A&D M&A volume and value comparison 2009-2010 (US\$ billions)



Source: Capital IQ.

Due to return of normal valuation multiples, availability of credit, largely deleveraged balance sheets of strategic buyers, and the opportunity to create more economies of scale by consolidating Tier one and two companies, more M&A activity is expected in the remainder of 2010 and the next few years.

²⁰ "Northrop Grumman gets \$40B deal to replace Air Force tankers," CNN.com/us, 1 March 2008.

“We expect to see more deals by private equity and strategic buyers alike as competition for desirable assets heats up over the next several months. In addition, strategic buyers will increase their focus expanding beyond established markets.”

— *Pauline Biddle, Aerospace & Defence Leader,
Deloitte UK and Switzerland Manufacturing Group*

In particular, with defense spending for weapons procurement expected to decline, it is anticipated the larger defense companies will become more aggressive in acquiring smaller companies specializing in the new areas of focus. These areas include intelligence, surveillance and reconnaissance, cyber security, alternative energy, data fusion, and mission operations software development. For commercial companies, an uptick in M&A activity is expected in the aerostructures and components manufacturing area as original equipment manufacturers and platform providers respond to the demand for lower prices in an increasingly commoditized market.

Additional opportunities will be created for commercial companies to consolidate in order to gain scale economies, resulting in lower-priced parts. This part of the market is expected to experience an uptick in sales, cash flows, and earnings metrics due to the recovery of the commercial aircraft production market. It is expected there to be competition between strategic buyers and private equity, thus driving up the deal multiples.

Midyear outlook summary

Although the global economy suffered mightily in 2009, the A&D sector held its own with flat financial performance. So far in 2010, the industry is holding its own with continued flat performance, although a no-growth forecast in revenues and profits is a cause for concern. Commercial aircraft is expected to take off in the medium term. Orders for new aircraft thus far indicate that airline operators sense the end of the recession and a return to normalized growth in air traffic. Business and general aviation had a tumultuous experience in 2009; however, the subsector is expecting a tentative growth in orders and production for the remainder of the year.

On the defense side, it is a different story. With the expected decline in global government defense spending, companies are looking for new markets in adjacent areas of business, as well as foreign military markets in developing countries. For growth in core markets, competitions will be hard fought with fewer program starts, leading to more contentious selections and procurements — potentially resulting in more protests. As topline growth moderates, defense companies are expected at a minimum to cut costs in order to maintain flat profits — usually not good enough for the global stock markets. Thus, defense companies will need to grow revenues in the new areas, as well as cut costs dramatically in order to demonstrate profitable growth in order to meet share price performance expectations.

Despite the opportunities and challenges for the remainder of 2010, the industry is still strong, with no bankruptcies of importance to note, global employment holding steady at approximately two million A&D jobs, and financial performance, albeit flat, which seem to be doing better than many other sectors hit hard by the global recession.²¹ However, the sector is in the midst of a change in vector and the challenge is to adapt and capitalize on the new opportunities.

²¹ “2009 Global Aerospace & Defense Industry Performance Wrap-up,” Deloitte Development LLC, 11 May 2010.

For further information

For more information, please visit us on the web at www.deloitte.com/manufacturing.

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