

November 9th, 2010

Bank of America Merrill Lynch Defense News Defense Outlook Forum

**Strategic Challenges and Opportunities Facing the Defense
Industry**

New York, NY



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6 Questions for the Defense Industry

1 *What does the industry do with its cash?*

2 *What strategies were adopted during the last inflection point?*

3 *Is M&A a viable strategy?*

4 *How important will the international defense markets be as a source of future growth?*

5 *What if everyone is wrong and there is no downturn?*

6 *What are current valuations telling us?*

1. What does the industry do with its cash?

Company	Cash and Equivalents (\$M)*
Boeing	\$9,215
BAE	\$5,966
United Technologies	\$4,449
Finmeccanica	\$3,769
Northrop Grumman	\$3,275
Raytheon	\$2,642
Lockheed Martin	\$2,391
General Dynamics	\$2,263
ITT	\$1,216
L-3	\$1,016
SAIC	\$936
Harris	\$281
CACI	\$208
Total	\$38,568

**Note: All numbers from 2009 Annual Reports
Sources: CAPIQ, RSAdvisors analysis*

The major aerospace/defense firms have extremely low net debt levels

- About \$5 billion of net debt according to company reports or about 2% of enterprise value

The industry now generating \$20+ billion of free cash flow

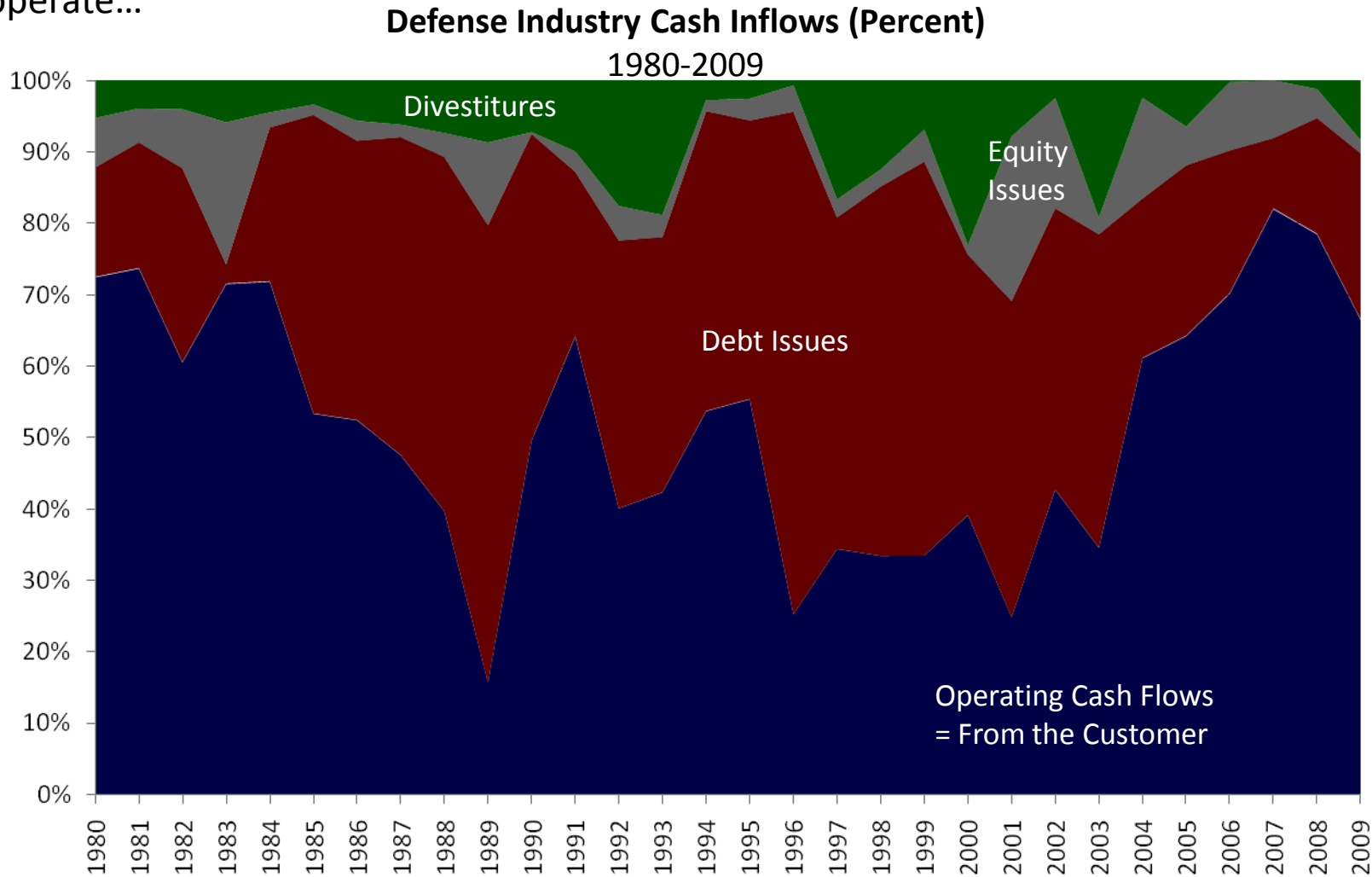
Potential use of the cash

- Reinvest in the business
- Find adjacent growth/diversification
- Acquisitions
- Share repurchases
- Dividends

Sources: CAPIQ, Company released information, RSAdvisors analysis

1. What does the industry do with its cash?

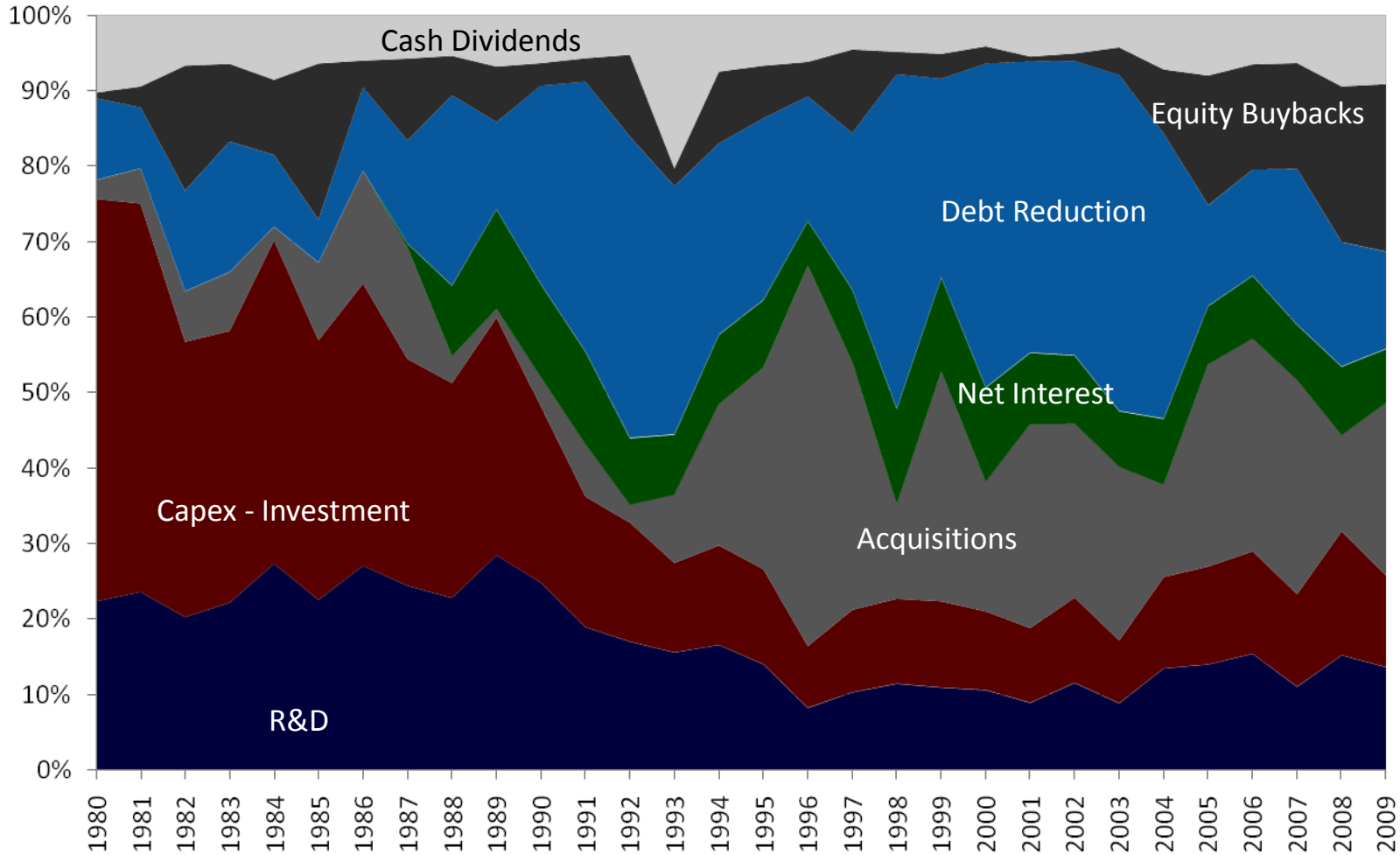
- In the last 30 years, financial markets have provided 40-80% of the capital needed to operate...



Sources: CapitalIQ, FactSet, company filings, RSAdvisors analysis

1. What does the industry do with its cash?

**Defense Industry Cash Outflows (Percent)
1980-2009**



Sources: CapitalIQ, FactSet, company filings, RSAAdvisors analysis

- The last cycle says that there are advantages to doing something and being first

Strategies Adopted by the Top 20 Defense Firms, 1991-1994

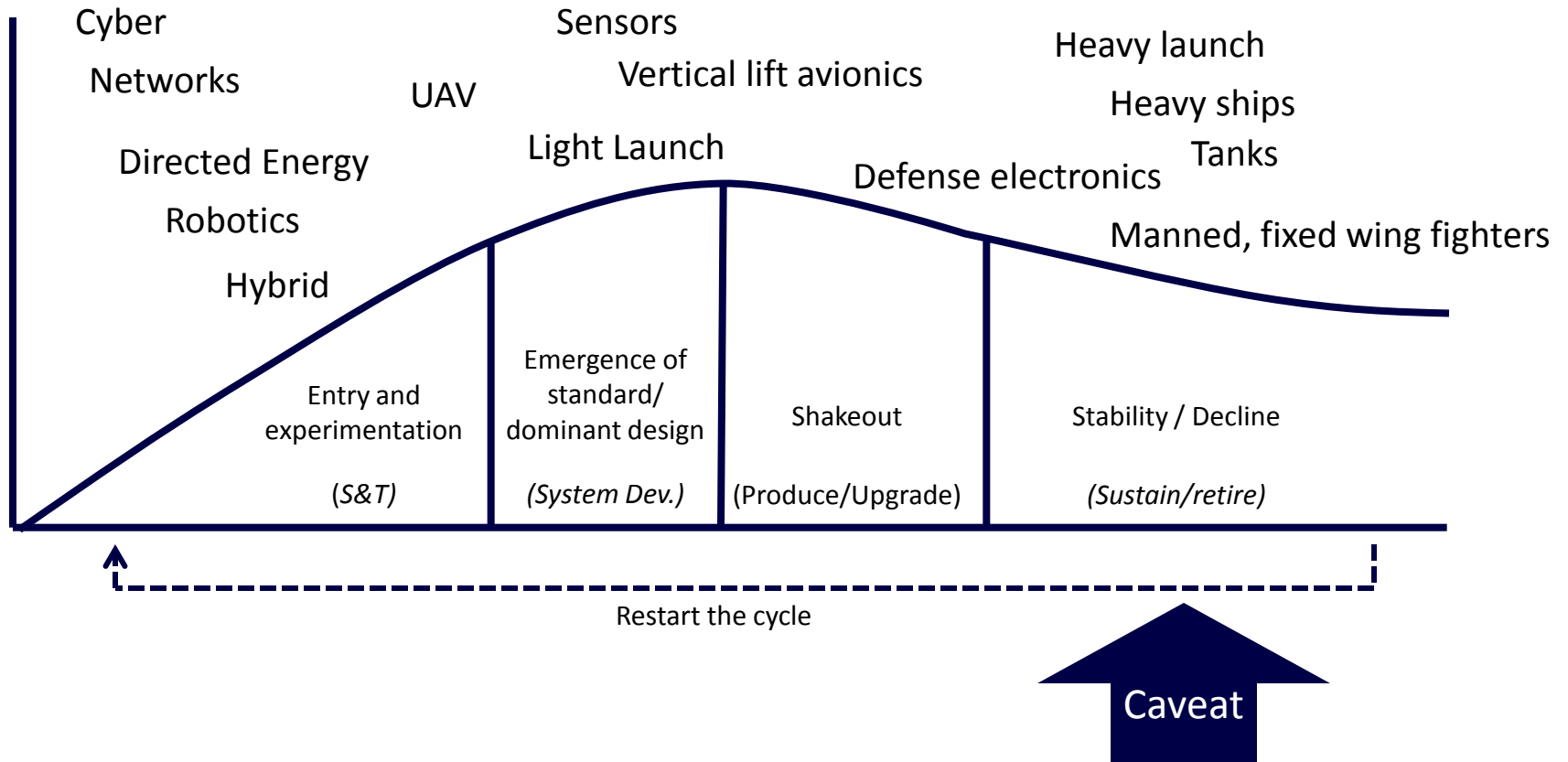
Strategy	Revenue Growth	Earnings Margin	P/E 1991	P/E 1994	EV/EBIT 1991	EV/EBIT 1994	Share Performance
M&A	26%	4.1%	7.5x	17.6x	5.3x	5.8x	153%
Commercial Diversification	1%	4.2%	9.4x	14.2x	4.5x	5.8x	55%
Ride the Wave	-8%	1.4%	13.9x	16.4x	5.1x	5.6x	88%

Strategies Adopted by the Top 20 Defense Firms, 1994-1999

Strategy	Revenue Growth	Earnings Margin	P/E 1994	P/E 1999	EV/EBIT 1994	EV/EBIT 1999	Share Performance
M&A	56%	4.5%	18.4x	18.2x	5.5x	7.7x	88%

Source: RSAdvisors analysis

2. What strategies were adopted during the last inflection point?



Caveat
Fight wars with the military you have

Source: RSAdvisors analysis

3. Is M&A a viable strategy?

- Of the 42 transactions proposed in 2009, the Pentagon only objected to 2 of them and one was asked to be moved to a “Merchant Supply Agreement”

Acquirer	Target	Value (\$M)	Pentagon's Position	Product Area
Atlantic Marine Holdings	Boston Ship Acquisition	N/A	Object, but insufficient case for Antitrust Agencies to intervene	Military Sealift Command Ship Repair
Microsemi	Semicoa	\$25	Objected. Supported Divestiture	Space-Qualified Transistors & Diodes
L-3	Chesapeake Sciences	N/A	Merchant Supply Agreement	Undersea Warfare Sensors

- No “Last Supper” or broad policy statement yet
- Undertaking sector by sector reviews to assess health of particular industrial bases, and to identify policy positions regarding competition, M&A, etc.

Sources: US Department of Defense, RSAdvisors analysis

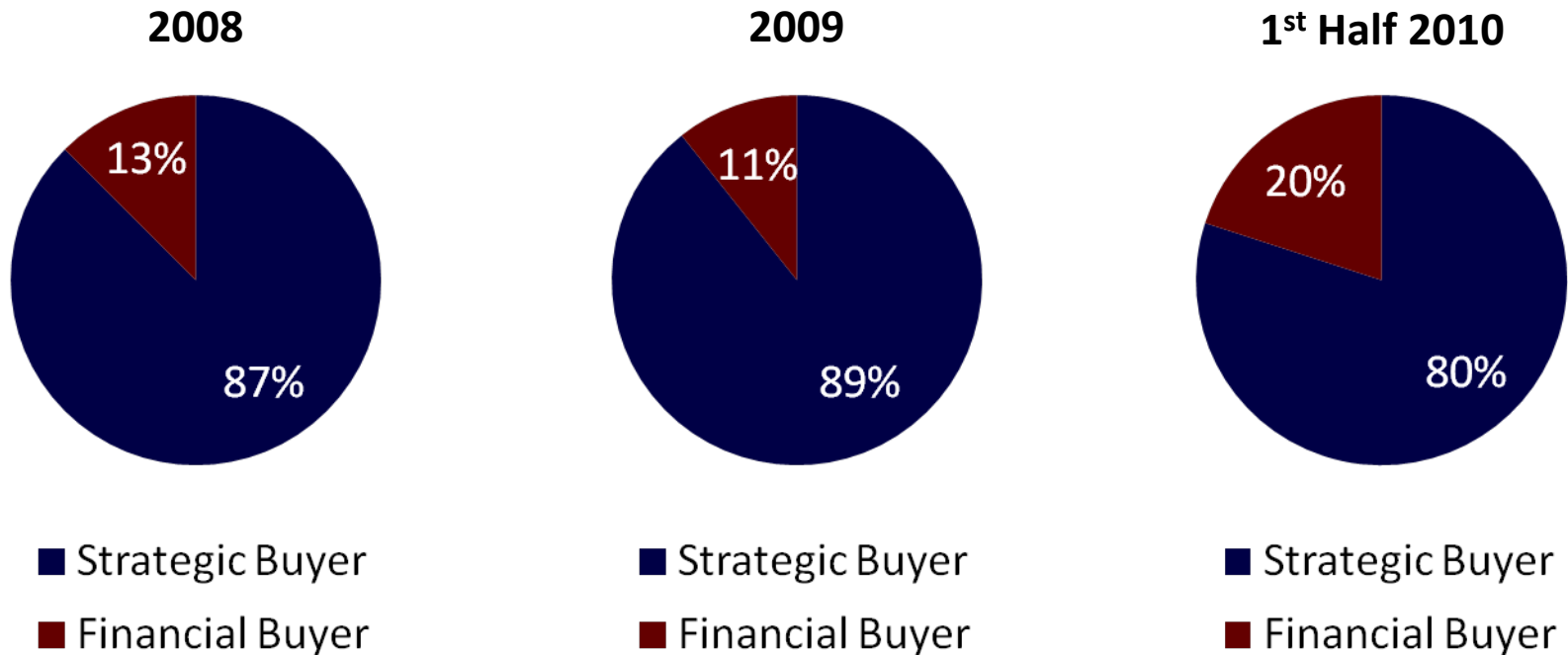
Key M&A Trends for the Aerospace & Defense Industry

Trend	Reason	Evidence
Moving towards an area of strategic divestures	Big properties are becoming available	-Northrop is looking to sell its ship business -Lockheed's services business is for sale -BAE is selling its Platforms Solutions business -Argon ST was sold to Boeing -Northrop sold its service business (TASC)
Supply chain restructuring	Program performance is slipping and costs are rising	Boeing acquires the Vought 787 factory and JV with Alenia to bring the project under tighter management and potentially reduce costs
Full life cycle support	The aftermarket represents a longer, more stable revenue stream	General Dynamics acquires Jet Aviation (general aviation maintenance, completions, engineering, fixed base operations, & aircraft management) for \$2.3B
MOOTW – military operations other than war (“soft power”)	Shift in focus due to Iraq/Afghanistan and new administration	L3 acquires International Resources Group, a support provider of energy, environment and natural resource management, relief and reconstruction, and economic development
Foreign investors seeking access to DoD and US commercial market	US budget still the only real game in town	Finmecannica acquires DRS (a supplier of integrated defense electronics products, services and support) for \$5.1B
Financial sponsors are making some moves	Increased willingness to lend in addition to senior management looking to potentially divest assets	Financial sponsors executed 13% of transaction in 2008 over \$50M, 11% in 2009, and 20% in the first half of 2010, according to PWC

Sources: CAPIQ, Industry news, PWC, RSAdvisors analysis

- Since 2009 Defense deals have been happening at high multiples with a particular emphasis on Cyber deals
 - Cyber: 10.8x
 - C4ISR: 9.6x
 - Other Defense: 7.2x

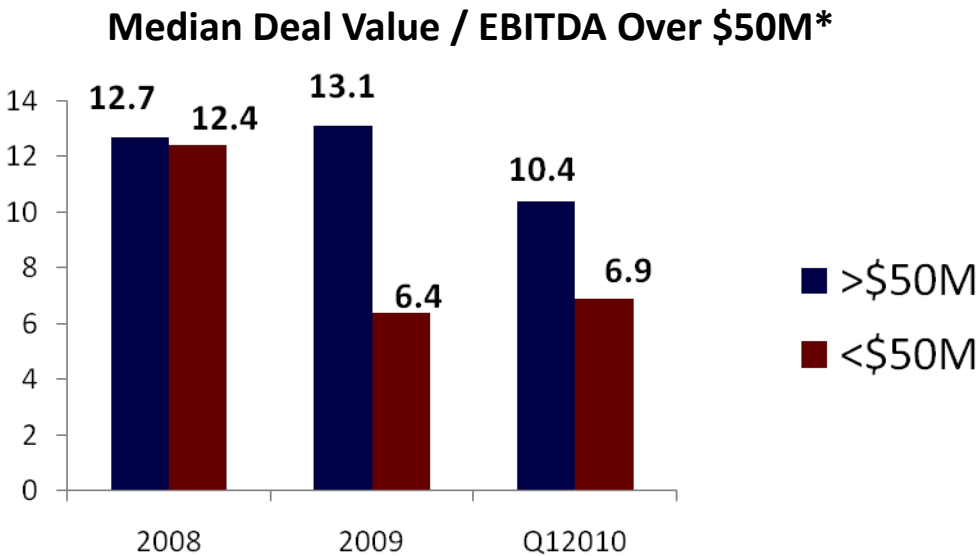
Defense M&A Activity for Transaction over \$50M



Sources: PWC, KippsDeSanto & Co, RSAdvisors analysis

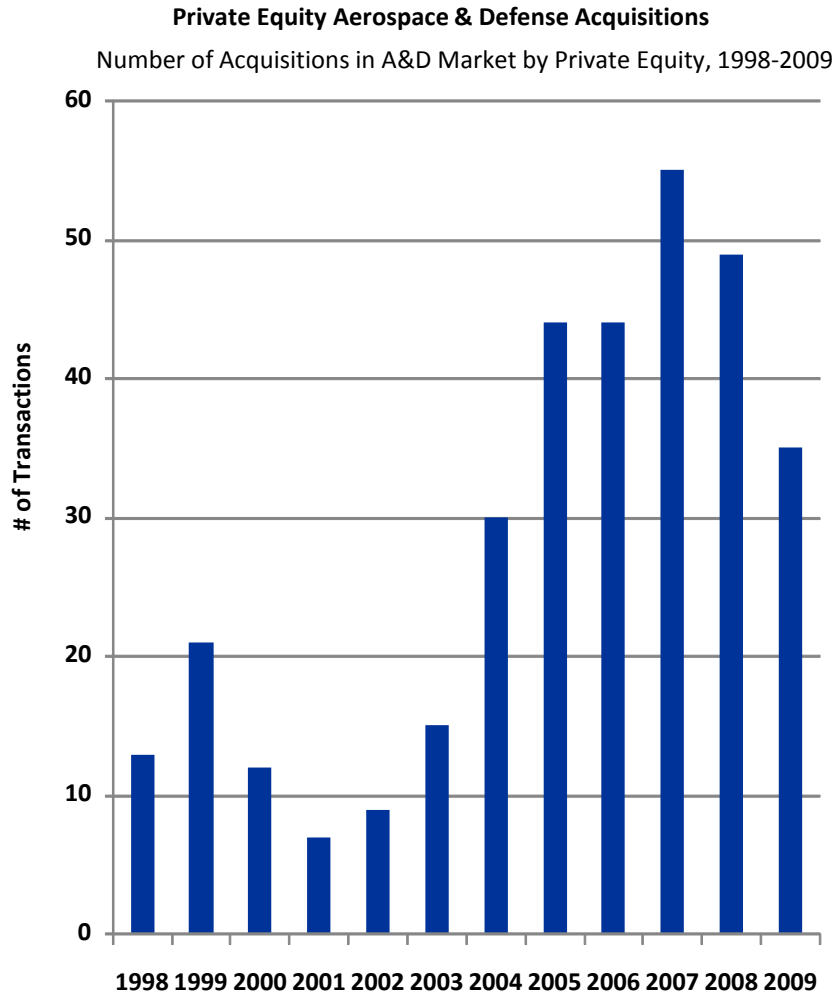
- There is a clear premium being placed on scale businesses...

Disclosed Aerospace & Defense Mergers & Acquisitions
2008 vs. 2009 vs. up to 1st Half 2010



*Note: Only includes Q12010
Sources: CAPIQ, PWC, RSAdvisors analysis

- Private Equity firms have shown a growing interest in the defense market over the past few years

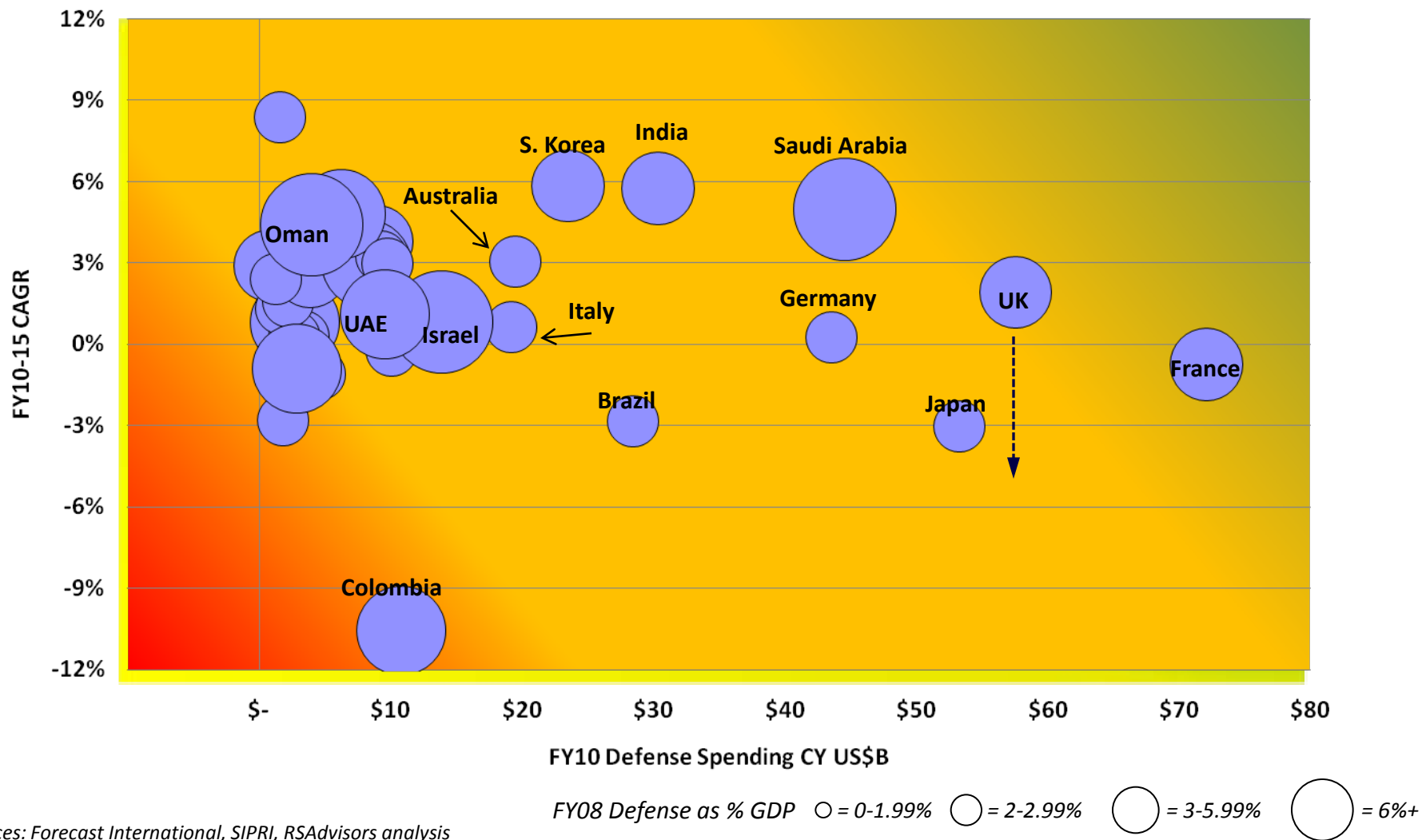


Source: RSAdivisors analysis

Private Equity Investment Strategies

- **Seek out well managed companies in out-of-favor sectors**
 - Carlyle's early model
 - Limited play as "low-hanging fruit" is gone and the rise in popularity of defense investing
- **Assemble large firms through the acquisition and integration of multiple firms**
 - Popular over the last 5-years, but large firms that can be integrated are limited
 - E.g. Anteon, Overwatch Systems
- **Assemble niche firms through the acquisition and integration of multiple firms in same market/tech space**
 - Growing interest in niche tech markets and service markets (e.g. Intel/Black)
 - PE behaving more like traditional firms with a "synergy and fit" model vice "buy-hold-sell"

- Although small in \$\$ terms, there are many markets showing positive growth over the next 5 years

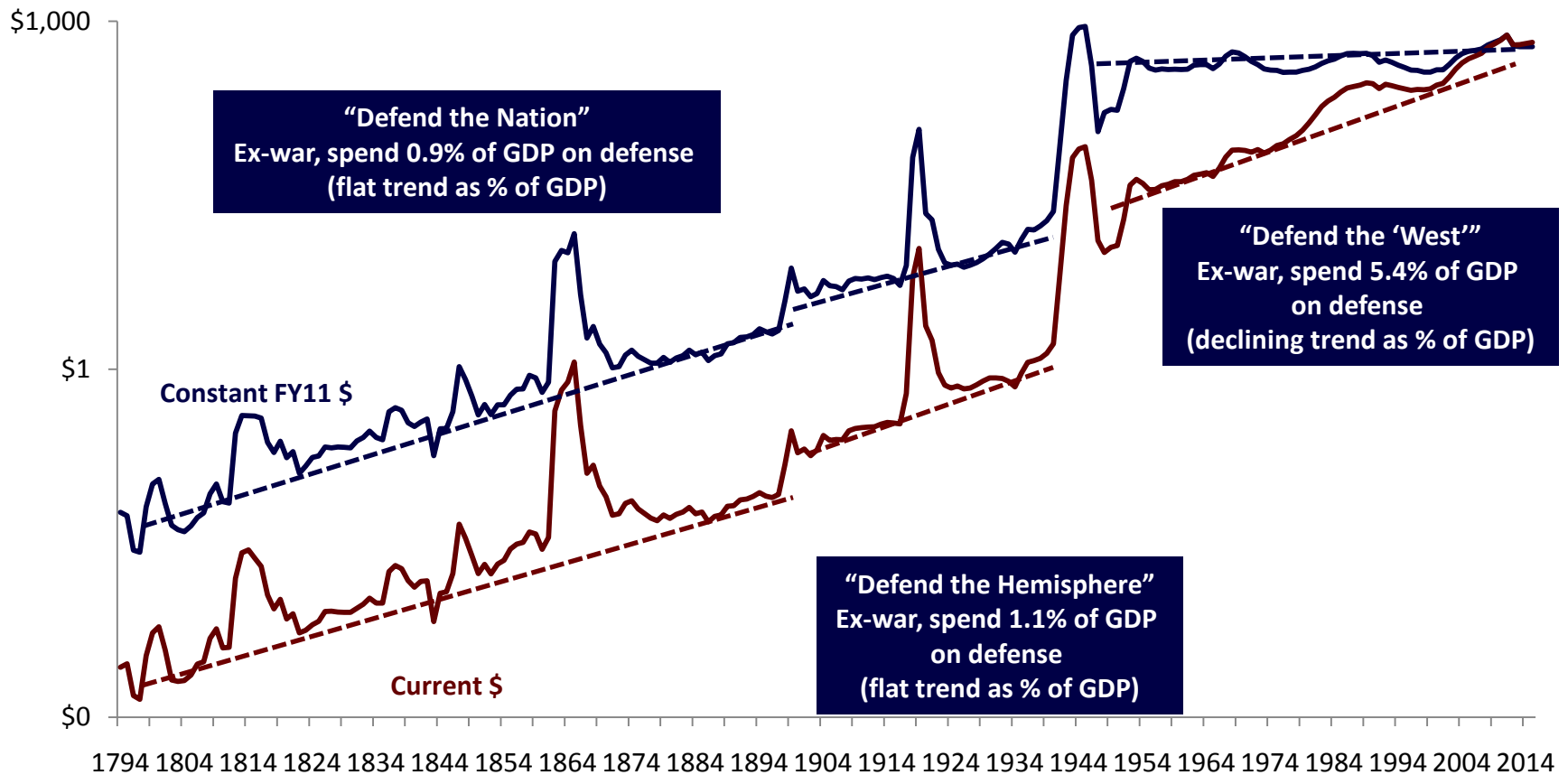


Sources: Forecast International, SIPRI, RSAdvisors analysis

- US defense spending has oscillated within three spending bands over US history...

Historical US Defense Spending

Current and FY11 Constant \$B Defense Spending, 1794-2015



Sources: US Department of Commerce, US Department of Defense, RSAdvisors analysis

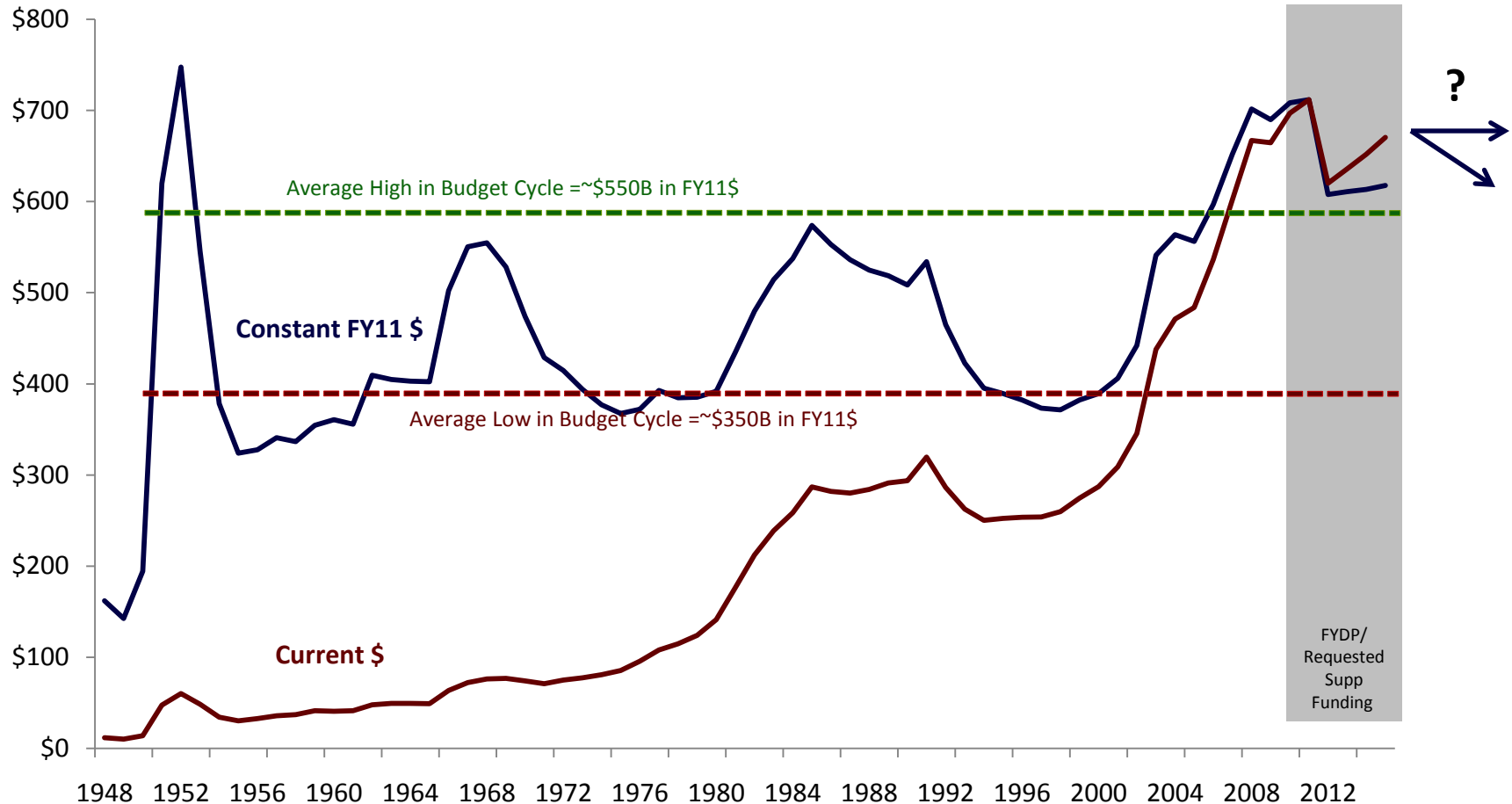
Where is the defense budget headed?

5. What if everyone is wrong and there is no downturn?

- ...post-WWII, we have stayed within a \$350B-\$550B “bounded range”; current wars have us above the range and begs the question...are we in a new band?

Modern US Defense Spending, 1948-2015

Planned Budget Authority in Constant \$B Including Supplementals and FY11 FYDP (does not forecast additional supplementals)

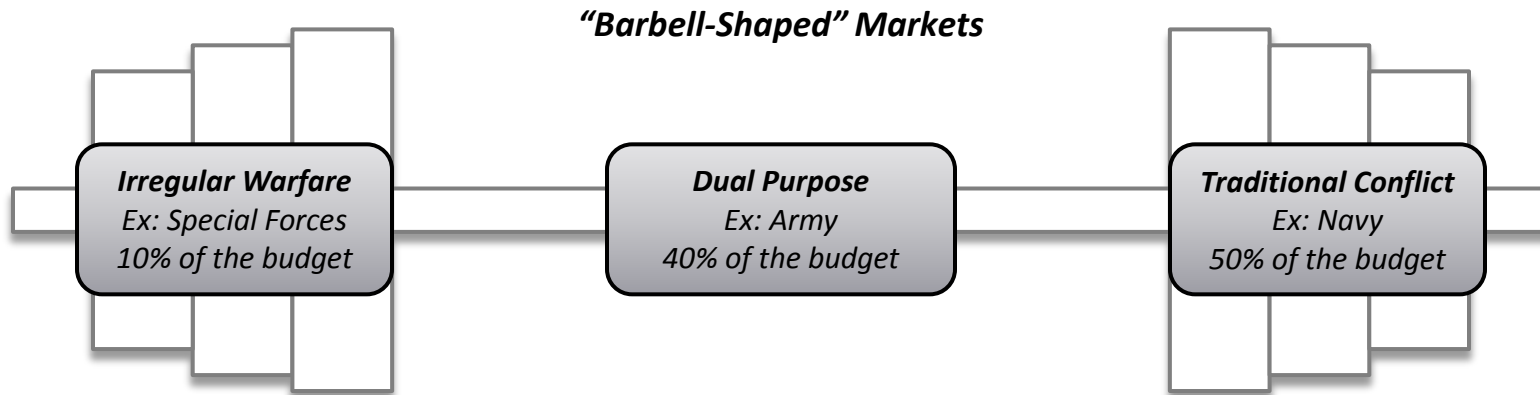


Sources: US Department of Defense, RSAdvisors analysis

Where is the defense budget headed?

5. What if everyone is wrong and there is no downturn?

- And with US DoD facing a wide spectrum of threats, from the fight of today to future, near-peer adversaries, how do you organize to address it?



The Long War

Slice #1

Rapid acquisition, off-the-shelf/short development, quick response is key, COCOM centric

Deterrence

Very long cycle, tech. development, platform-oriented but limited production, services centric

Reset/Retrofit

Slice #2

Install “black boxes” in existing equipment to plug into network, maintenance, repair

Transformation

Desire for large, horizontal integrating networks, leverage the IT revolution

Slice #3

Operational and Policy Support Oriented Services

Logistics, operations, and intelligence support

High-skilled Services

Technically skilled services

Is it one or two industrial bases? Can they be the same suppliers? How does DoD organize?

Sources: US Department of Defense, RSAdvisors analysis

- The industry is trading in lockstep, public markets not differentiating...

Primes

	TEV/LTM EBITDA	TEV/NTM EBITDA	P/LTM EPS	P/NTM EPS
BAE	3.92x	4.85x	8.76x	8.42x
GD	6.31x	6.62x	11.81x	11.25x
LMT	5.27x	5.27x	10.73x	9.65x
NOC	5.67x	6.18x	12.07x	12.66x
RTN	6.08x	5.22x	11.96x	9.96x
AVG	5.45x	5.63x	11.07x	10.39x
Boeing*	7.78x	7.52x	16.66x	15.75x

Professional Services

	TEV/LTM EBITDA	TEV/NTM EBITDA	P/LTM EPS	P/NTM EPS
CACI	7.33x	7.51x	14.46x	15.00x
CGI Group	6.05x	6.52x	14.14x	15.61x
ManTech	6.79x	7.89x	12.39x	13.39x
SAIC	6.35x	6.53x	11.54x	12.69x
SRA	7.39x	7.62x	15.82x	16.72x
CSC	3.83x	3.83x	11.70x	9.91x
AVG	6.69x	7.19x	14.20x	14.84x

Note: * Boeing not included in averages, numbers as of 11/5/2010 market close

Sources: CAPIQ, RSAdvisors analysis

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