

March 7th, 2012

Speednews 26th Annual Commercial Aviation Industry Suppliers Conference

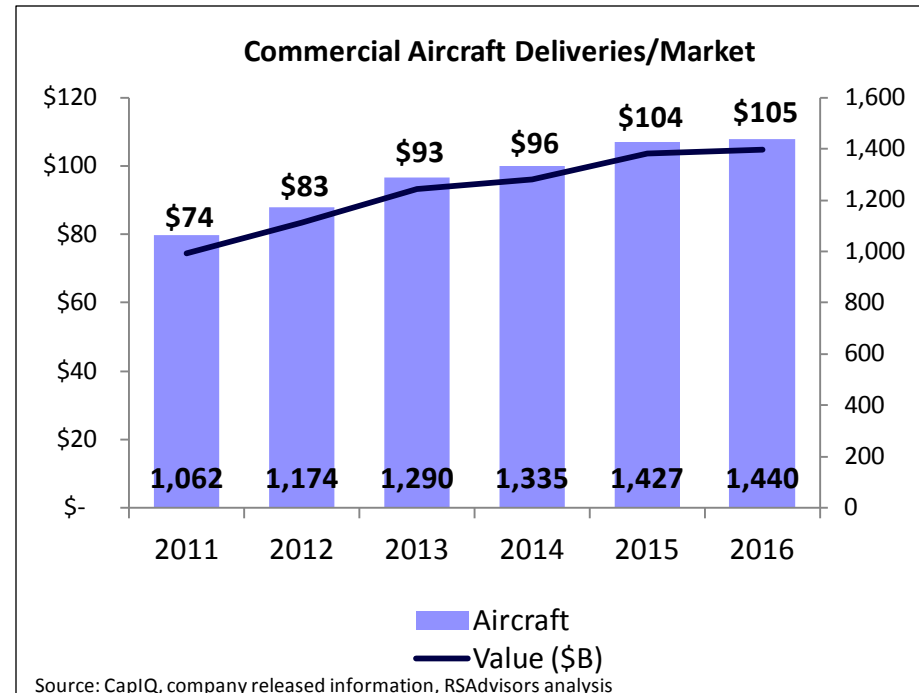
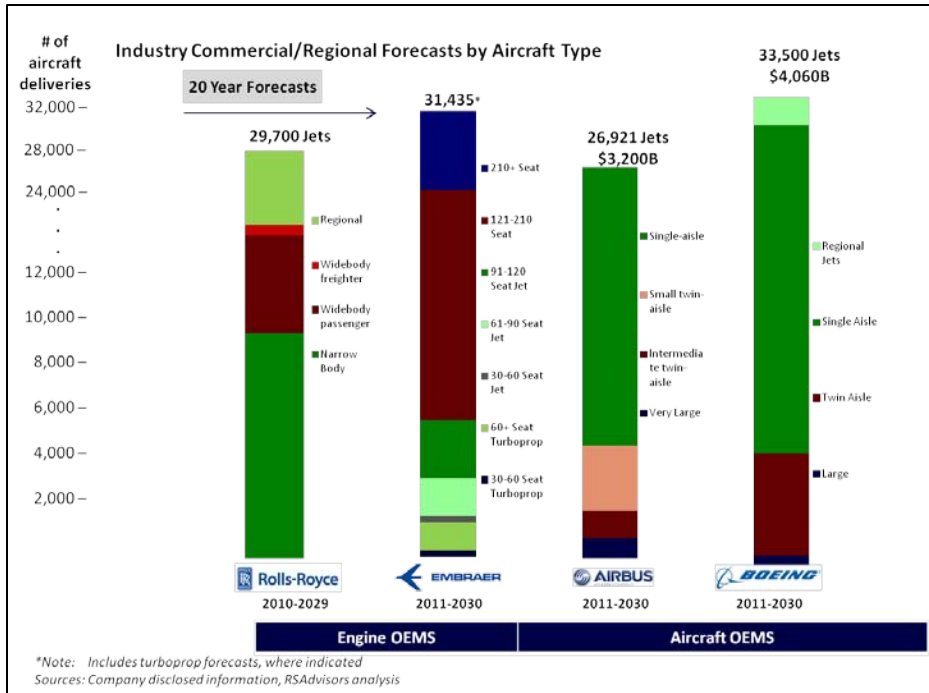
**The Strategic Opportunities & Challenges Facing the
Aerospace Industry – Six Key Questions**

Beverly Hills, CA



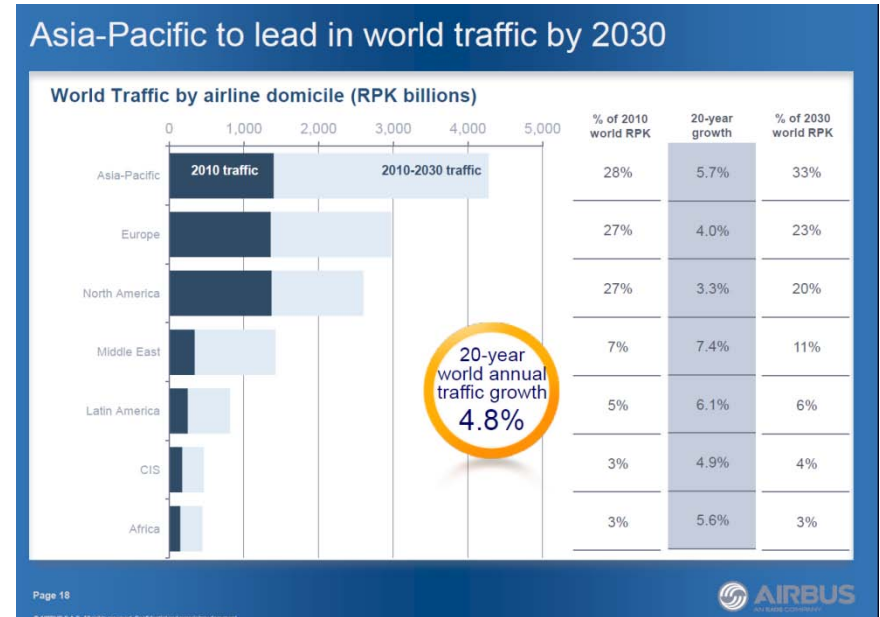
1300 Wilson Boulevard, Suite 500
Arlington, VA 22209
703-504-9300
pchao@rsadvisors.com

Where Exactly Are We in the Cycle?



- Large market (we know), currently on the upramp (we know)
- US economy sluggish but recovering, Asia still growing, Europe heading to (in?) recession
- Big backlogs underpinning production upramps (health of backlogs is analysis worthy)
- Talk of a super cycle (uh oh)
- **Fundamentally/strategically a capital allocation question – how much capacity to add**
 - Subsidiary issue – if you don't, will someone else? Window of opportunity for global new entrants and new "second sources"

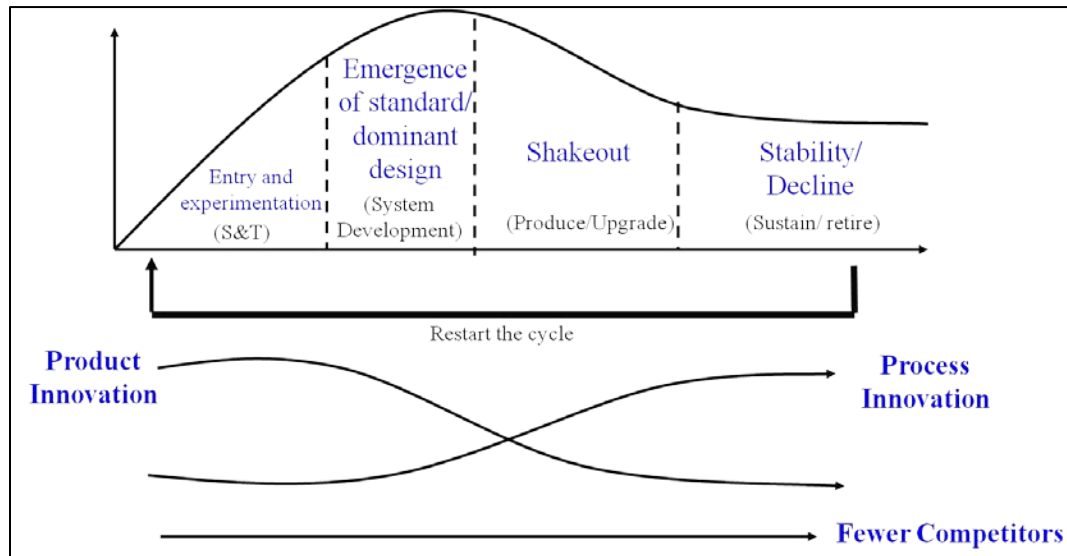
Where is the Geographic Source of Future Growth?



- Asia continues to be identified as the largest future market
 - Geography says this is a long haul market
- However, replacement market is US/Europe centric and is narrow body oriented
- What is an appropriate supply chain/growth strategy?
 - OEM perspective – search for qualified suppliers not easy
 - Supplier perspective - finding partners not easy, M&A even harder
 - Am I building a great partner/supplier or a competitor?

What is the Basis of Competitive and Strategic Differentiation?

- What should suppliers use as the core basis of strategic differentiation?
- At its heart the question centers on technological/product innovation vs cost/process innovation
 - Not really either/or but matter of emphasis
- Revolutionary needed to move the needle/restart the product cycle (order of magnitude)
 - Speed – supersonic/hypersonic? Or other radical ideas – suborbital (the physics of a parabolic curve)
 - Alternative fuels?
- Evolutionary ideas geared towards lowering operating costs, cost of ownership, etc.
- Business model innovation as another basis of differentiation



Source: CSIS Defense Industrial Initiatives Group,
James Utterback

What is the Best Aerospace Product Portfolio Strategy?

- How broad does a supplier's product portfolio need to be?



**United
Technologies**

Honeywell



GOODRICH

**Rockwell
Collins**

- The more the industry shifts towards a cost focus, business models shift risk to supplier base and global presence is critical – the more scale will matter
 - Only certain subsegments can accommodate large scale and focused portfolios
 - Otherwise, broadening exposure becomes key
- Where there is room for technological innovation (order of magnitude changes) then focused portfolios at a smaller scale can be accommodated (see Question #6)

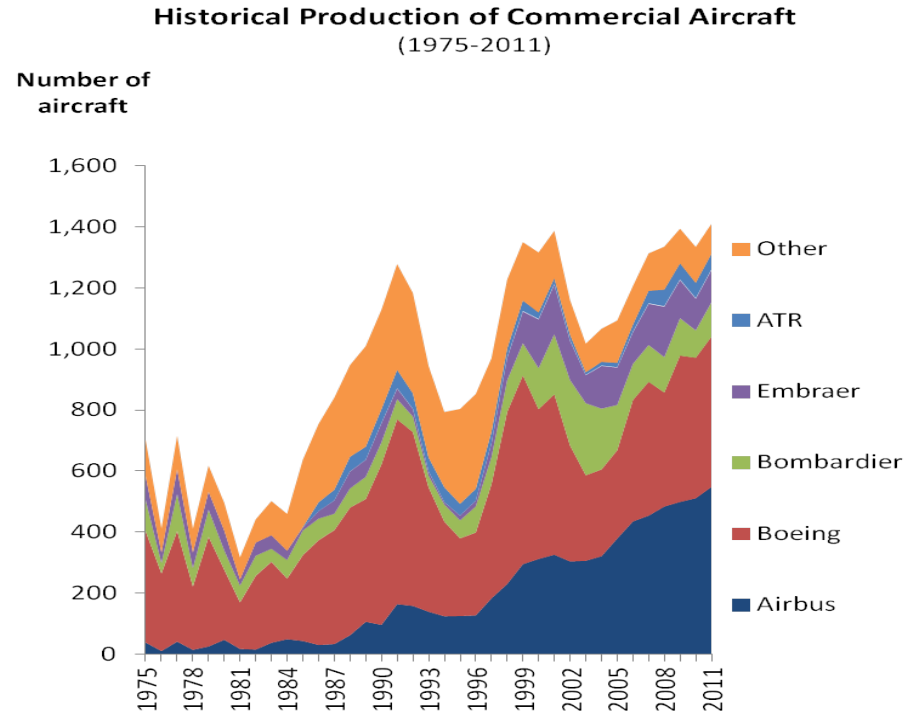
GARMIN[™]

COMPOSITES

- Focused portfolios are getting rarer – what does that tell you?

How Do You Mitigate the (Inherent) Cyclicity of the Industry?

- This is a growth but cyclical market
 - Highs are higher, lows are higher; but there are still large swings
- Two fundamental strategies
 - Balance OEM exposure with aftermarket exposure
 - Balance aerospace exposure with non-aerospace (defense, industrial, broader conglomerate)
- Both are being examined/re-examined by industry participants
 - Role of aerospace in broader portfolios
 - Wall Street implications – trade off between higher but more volatile multiples/valuation versus more stable but lower relative valuation (and risk of conglomerate discount if you overshoot)
- This issue will drive the characteristics of future M&A activity



Source: Ascend, Airline Monitor, RSAdivisors analysis

**1300 Wilson Boulevard
Suite 500
Arlington, VA 22209
703-504-9300
pchao@rsadvisors.com**

