

## UBS Investment Research

## UBS Business Jet Survey

## Recovery Stalls

24 March 2010

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## ■ Index holds at 50

Our March Business Jet Index came in at 50, indicative of a stable market and in line with our prior survey from January following increases in each of our previous eight surveys. While our Index continues to reflect a stable market, our straight up measure of absolute business conditions moved modestly lower this time, the first decline since March of 2009 and indicative of a slight degradation in market conditions since January.

## ■ Survey reflects improving customer interest

Our survey continues to reflect improving customer interest and a strong 12-month outlook, although it is still weighed down by very high used inventory levels. Pricing in most models is off 30-40% from peak levels, but now appears to be stabilizing. Overall, our respondents cited an increased willingness to add to their own inventories this time, reflecting increased confidence in near-term pricing/liquidity. Despite improved buyer interest/outlook, we think significant oversupply on the used market, particularly in small/midsize aircraft, will continue to overhang new aircraft orders.

## ■ Prefer GD/COL

Our Buy rating on GD reflects an improved defense risk profile and stabilization in our bizjet survey, with particular strength at the high end. Our Neutral rating on TXT reflects concerns over the shape of the recovery at Cessna, given significant oversupply, fractional weakness, and increased competition at the low-mid end (Embraer). Of the suppliers, Buy rated COL is our preferred play on business jets.

Chart 1: UBS Business Jet Market Index

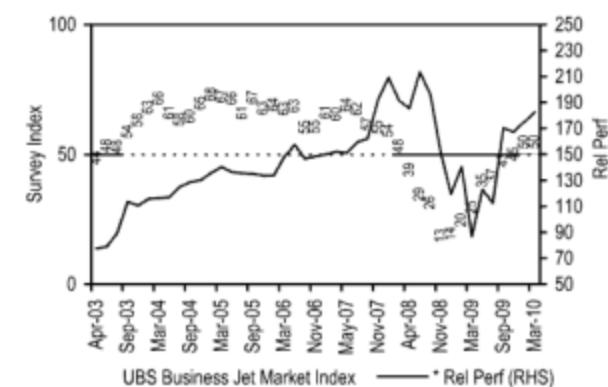
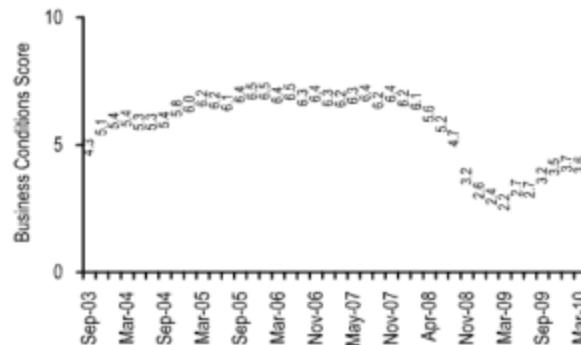


Chart 2: Overall Business Conditions Score



\* Simple average stock price performance index includes GD/TXT

Source: UBS Business Jet Survey #1-44

Source: UBS Business Jet Survey #1-44

This report has been prepared by UBS Securities LLC

**ANALYST CERTIFICATION AND REQUIRED DISCLOSURES BEGIN ON PAGE 17.**

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## Business Jet Market Survey

Our UBS Business Jet Market Survey is designed to provide timely market data supplied directly by industry professionals. We regularly survey a group of US domestic and international broker/dealers, manufacturers, fractional providers, financiers and others, from whom we received 150 responses in March.

### Investment Conclusion

Our March Business Jet Index came in at 50, indicative of a stable market and in line with our prior survey from January following increases in each of our previous eight surveys. Our Index measures the change in our respondents' views from our prior survey and is not meant to be an absolute measure of business conditions. Our straight up measure of absolute business conditions continues to reflect a depressed market, moving modestly lower this time to 3.6 (from 3.7), the first decline since March of 2009 and indicative of a slight degradation in overall market conditions since our prior survey.

Our survey continues to reflect improving customer interest and a strong 12-month outlook, although it is still weighed down by very high used inventory levels. Pricing in most models is off 30-40% from peak levels, but now appears to be stabilizing. Overall, our respondents cited an increased willingness to add to their own inventories this time, reflecting increased confidence in near term pricing/liquidity. Despite improved buyer interest/outlook, we think significant oversupply on the used market, particularly in small/midsize aircraft, will continue to overhang new aircraft orders.

While not a component of our composite index, our young inventory score remains well below 50, indicating significant oversupply of high-quality young used aircraft. Our Financing score, also not a component of our index, continues to reflect incremental improvement in financing availability.

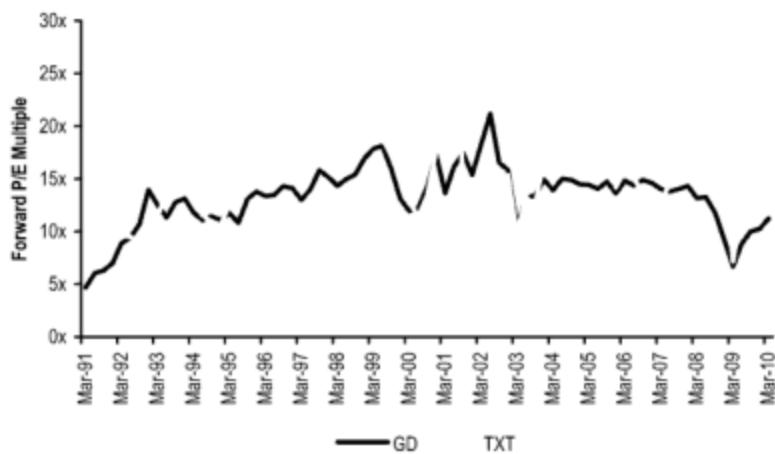
Table 1: UBS Business Jet Survey Results and Comparison to Prior Survey

Component	Better	Same	Worse	Score	Last Time	Change
Customer Interest	54%	39%	7%	74	76	-3%
Pricing	15%	66%	19%	48	45	7%
12 Month Outlook	61%	35%	4%	79	82	-4%
Inventory Levels	2%	6%	92%	5	7	-31%
Willingness	26%	53%	21%	53	50	6%
<b>Composite Index</b>	<b>29%</b>	<b>41%</b>	<b>30%</b>	<b>50</b>	<b>50</b>	<b>0%</b>
Young Inventory	8%	25%	67%	20	20	2%
Financing	24%	74%	3%	60	60	0%
<b>Business Conditions</b>	<b>n/a</b>	<b>n/a</b>	<b>n/a</b>	<b>3.6</b>	<b>3.7</b>	<b>-1%</b>

Source: UBS Business Jet Survey #43-44

Our Buy rating on GD reflects an improved defense risk profile and stabilization in our bizjet survey, with particular strength at the high end. Our Neutral rating on TXT reflects concerns over the shape of the recovery at Cessna, given significant oversupply, fractional weakness, and increased competition at the low-mid end (Embraer). Among the suppliers, Buy-rated COL is our preferred play on business jets.

Chart 3: GD and TXT Forward P/E Multiples

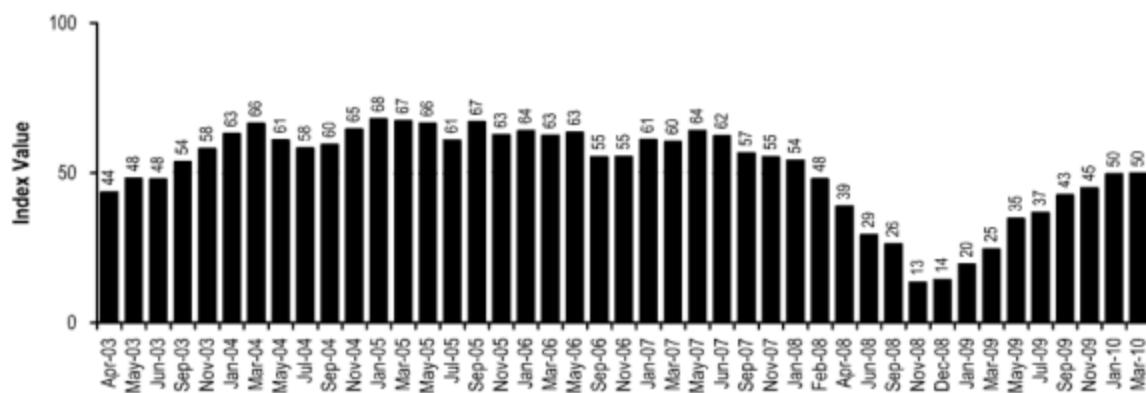


Note: Forward PE using rolling 12-month (actual) EPS through June 2009 and UBS estimates for future periods. TXT PE multiple for the current period reflects our 2010 estimate. Source: UBS estimates

## UBS Business Jet Market Index

Our UBS Business Jet Index is a proprietary index designed to measure the total “value” of the responses to our survey questions. We have weighted each factor in our index based on our perception of its overall importance to the condition of the new business jet market. Our index is scored on a scale of zero to 100, with 51-100 representing incrementally strengthening market conditions, 50 incrementally stable, and 0-49 incrementally weakening market conditions. Our March Business Jet Index came in at 50, indicative of a stable market and in line with our prior survey from January.

Chart 4: UBS Business Jet Market Index

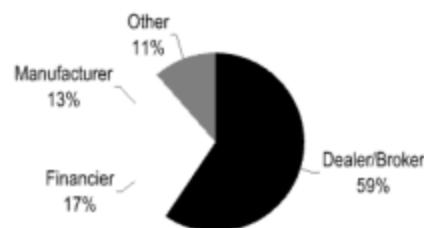


Source: UBS Business Jet Survey #1-44

## Survey Participant Profile

Of the 150 market professionals who responded to our survey, a majority (59%) are broker/dealers. Brokers/dealers are involved in the purchase and sale of both new (direct from manufacturer) and used aircraft, often purchasing on spec.

Chart 5: Business Jet Market Survey—Participant Role

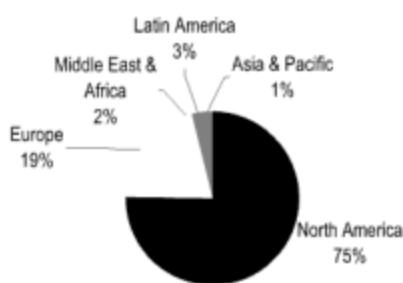


Note: Other includes appraisers, fractional providers, management, charter, FBO and MRO service providers.

Source: UBS Business Jet Survey #44

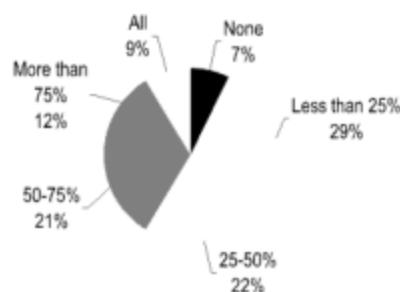
The majority of our participants are located in North America (75%), although most transact a significant proportion of their business with foreign customers.

Chart 6: Business Jet Market Survey—Participant Location



Source: UBS Business Jet Survey #44

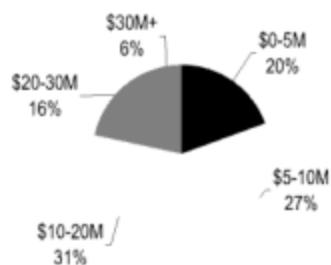
Chart 7: Proportion of Business Transacted Outside the US



Source: UBS Business Jet Survey #44

Respondents varied fairly uniformly in average transaction size with the majority in the \$5-20 million range.

Chart 8: Business Jet Market Survey—Average Transaction Size



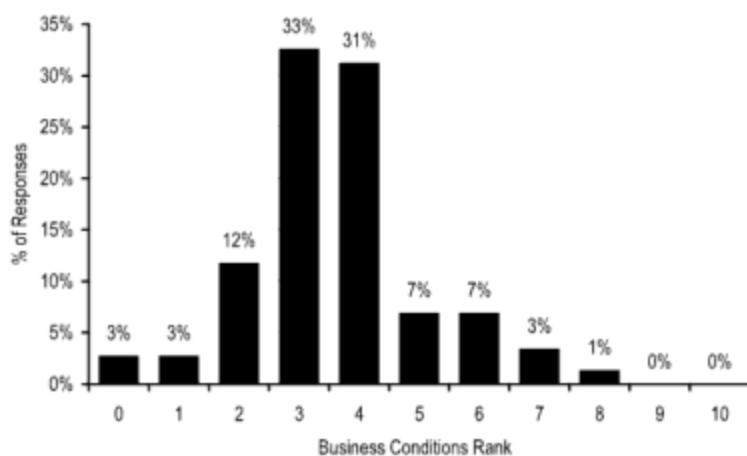
Source: UBS Business Jet Survey #44

## Survey Results

### Overall Business Conditions

In the first question, we asked, "On a scale of zero to 10, how would you characterize overall business conditions *after factoring typical seasonality* (0 = the worst ever, 5 = normal, 10 = the best ever)?" Note that while our Business Jet Market Index (discussed earlier) indicates *incremental change* from the prior period, this question is meant to measure the *absolute level* of business conditions. We received 144 responses (six participants did not respond to this question) with scores ranging from zero to eight.

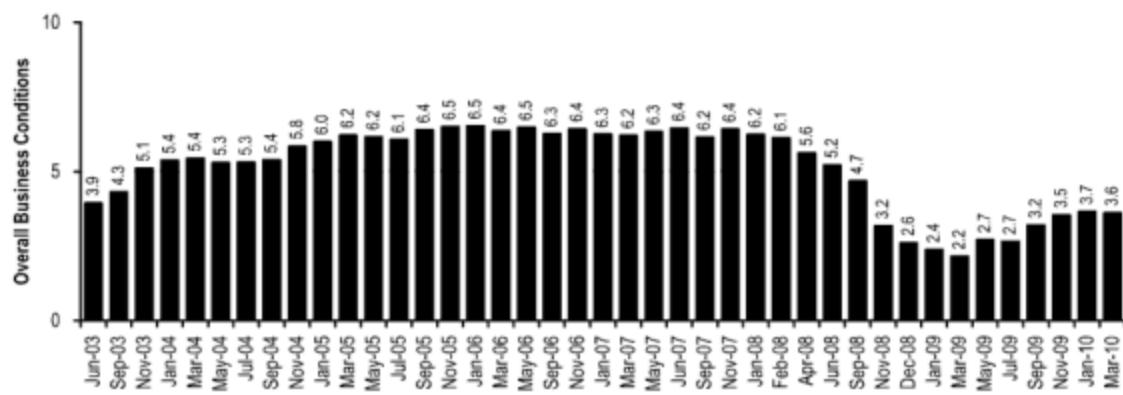
Chart 9: Indication of Overall Business Conditions, March 2010



Source: UBS Business Jet Survey #44

Overall, our average business conditions score came in at 3.6, 1% lower compared to our prior survey at 3.7.

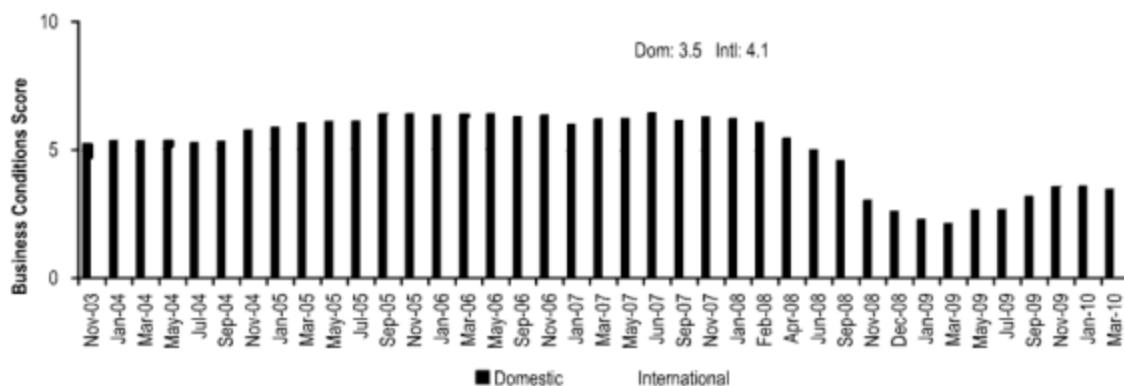
Chart 10: Overall Business Conditions Score



Source: UBS Business Jet Survey #144

This month's decline in overall business conditions was driven by our domestic participants, partially offset by a slight improvement internationally.

**Chart 11: UBS Business Jet Market Index**

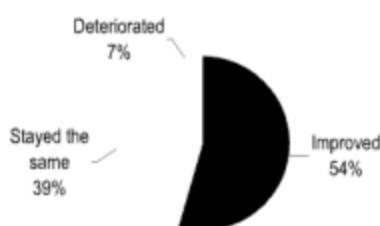


Source: UBS Business Jet Survey #144

## Customer Interest

In the next question, we asked, "Since our last survey in January, the level of customer interest improved, stayed the same or deteriorated?" Of the 147 responses (three participants did not respond to this question), 54% indicated that customer interest had improved, while 7% indicated that customer interest had deteriorated. The remaining 39% indicated that customer interest had stayed the same. This represents a modest decline from our prior survey, in which 55% indicated that customer interest had improved, 4% indicated customer interest had deteriorated and 41% indicated that customer interest had stayed the same.

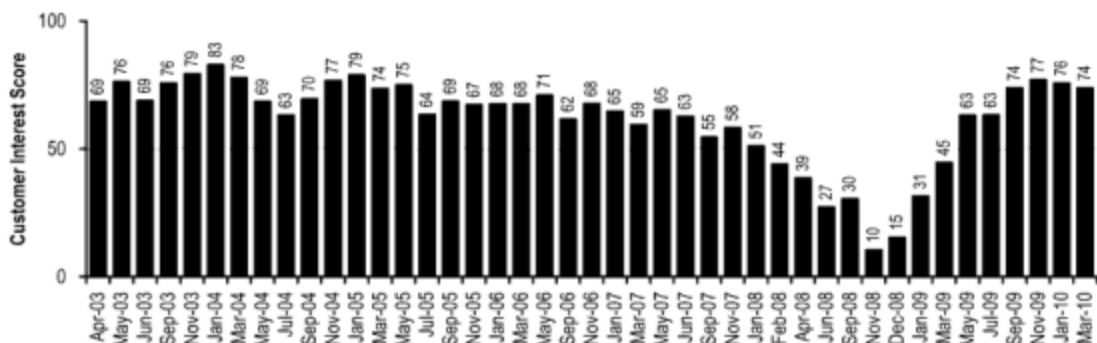
**Chart 12: Indication of Customer Interest, March 2010**



Source: UBS Business Jet Survey #44

Our customer interest score came in at 74, slightly lower from January, but still well above 50, indicating that on average customer interest is improving.

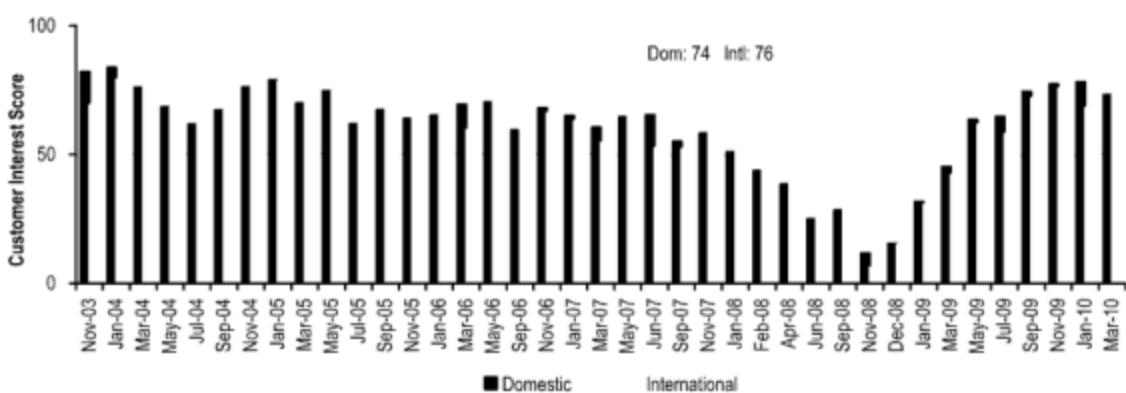
Chart 13: UBS Business Jet Survey Score—Customer Interest



Source: UBS Business Jet Survey #1-44

This slight decline in our customer interest score was driven by our domestic participants, while international customer interest increased this month.

Chart 14: Customer Interest, Domestic vs. International

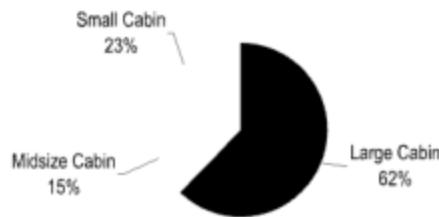


Source: UBS Business Jet Survey #1-44

### Customer Interest by Cabin Class

In the next question, our participants were asked to indicate the class of aircraft in which they were seeing the most interest from potential buyers. Respondents were asked to choose from Large Cabin, Midsize Cabin or Small Cabin. Of the 111 responses (39 participants did not respond to this question), 62% indicated they were seeing the strongest interest in large cabin aircraft, with 15% indicating midsize and 23% indicating small cabin. These results are broadly in line with our prior survey, in which 66% indicated they were seeing the strongest interest in large cabin aircraft, 14% indicated midsize and 20% indicated small cabin.

Chart 15: Cabin Class with Most Buyer Interest, March 2010

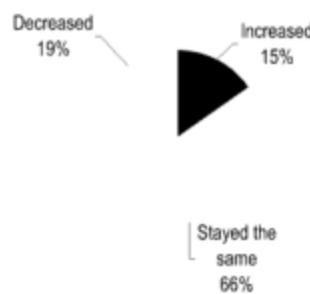


Source: UBS Business Jet Survey #44

## Pricing

In the next question, we asked, "Since our last survey in January, overall pricing levels increased, stayed the same, or decreased?" Of the 145 responses (five participants did not respond to this question), 15% indicated that pricing levels had increased, while 19% indicated that pricing levels had decreased. The remaining 66% indicated that pricing levels had stayed the same. These results represent an improvement from our prior survey, in which 14% indicated that pricing levels had increased, 24% indicated that pricing levels had decreased, and 62% indicated that pricing levels had stayed the same.

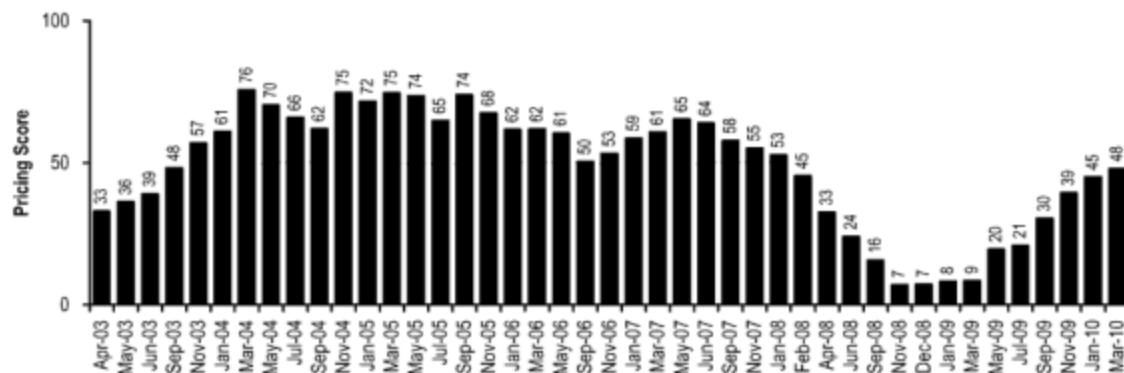
Chart 16: Indication of Pricing, March 2010



Source: UBS Business Jet Survey #44

Our pricing score increased 7% this time, the eighth straight increase, and is now nearing the 50 mark, indicating pricing is well on its way to stabilizing following significant declines over the past two years.

**Chart 17: UBS Business Jet Survey Score—Pricing**

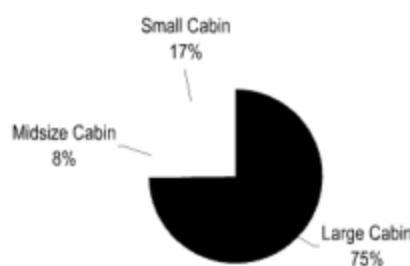


Source: UBS Business Jet Survey #1-44

### Pricing by Cabin Class

In the next question, our participants were asked to indicate the cabin class of aircraft in which they were seeing the strongest pricing. Respondents were asked to choose from Large Cabin, Midsize Cabin or Small Cabin. Of the 107 responses (43 participants did not respond to this question), 75% indicated they were seeing the strongest pricing in large cabin aircraft, with 8% indicating midsize and 17% indicating small cabin. These results are broadly in line with our prior survey, in which 71% indicated they were seeing the strongest pricing in large cabin aircraft, 12% indicated midsize and 17% indicated small cabin.

**Chart 18: Cabin Class with Strongest Pricing, March 2010**

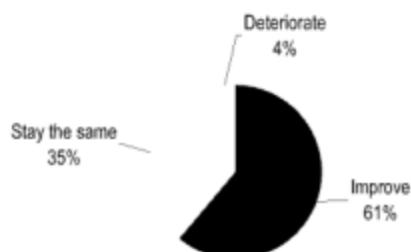


Source: UBS Business Jet Survey #44

## 12-Month Outlook

In the next question, we asked, "Over the next 12 months, do you expect overall business conditions to improve, stay the same or deteriorate?" Of the 149 responses (one participant did not respond to this question), 61% expect business conditions to improve, while 4% expect business conditions to deteriorate. The remaining 35% expect business conditions to stay the same over the next 12 months. These results represent modest degradation from our previous survey, in which 66% expected business conditions to improve, 3% expected conditions to deteriorate and the remaining 31% expected business conditions to remain relatively unchanged over the following 12 months.

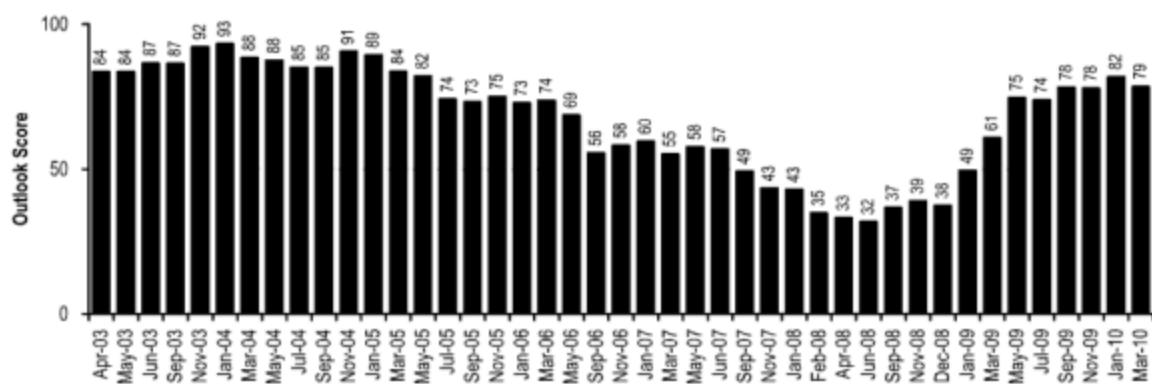
Chart 19: 12-Month Forward Outlook for Business Conditions, March 2010



Source: UBS Business Jet Survey #44

Our 12-month outlook score came in at 79 this time, slightly below our prior survey, but still well above 50, indicating that our survey participants expect market conditions to improve over the next 12 months on average.

Chart 20: UBS Business Jet Survey Score—12-Month Outlook

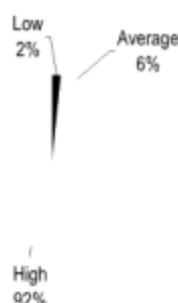


Source: UBS Business Jet Survey #1-44

## Overall Inventory Levels

In the next question, we asked, "How would you characterize current inventory levels?" In this question, we targeted broker/dealers, but in some cases, other participants also responded. The survey participants were asked to select "high", "average", or "low." Of the 128 responses (22 participants did not respond to this question), 2% believe inventory levels are low, while 92% believe inventory levels are high. The remaining 6% believe inventory levels to be at average levels. These results represent modest degradation from our previous survey, in which 1% believed inventory levels to be low, 88% believed inventory levels to be high, and the remaining 11% believed inventories to be at average levels.

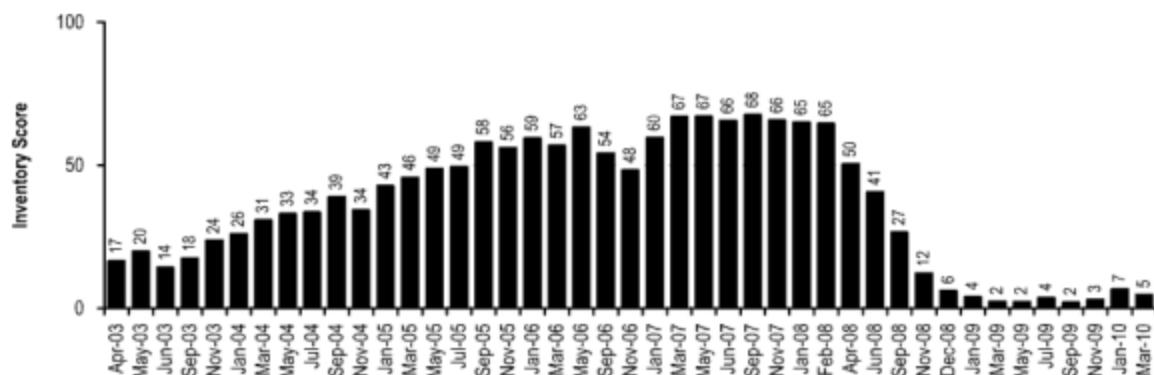
Chart 21: Indication of Inventory Levels, March 2010



Source: UBS Business Jet Survey #44

Our inventory score at five continues to reflect extraordinarily high overall inventory levels.

Chart 22: UBS Business Jet Survey Score—Inventory Levels

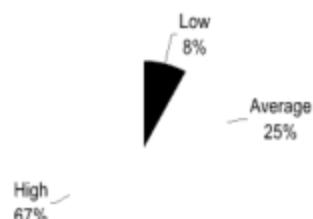


Source: UBS Business Jet Survey #1-44

## Young Inventory Levels

In the next question, we asked, "How would you characterize current inventory levels of relatively young used aircraft?" In this question, we targeted broker/dealers, but in some cases, other participants also responded. The survey participants were asked to select "high", "average", or "low." Of the 126 responses (24 participants did not respond to this question), 8% believe young inventory levels are low, 67% believe young inventory levels are high, and the remaining 25% believe young inventories to be at average levels. These results are roughly in line with our prior survey.

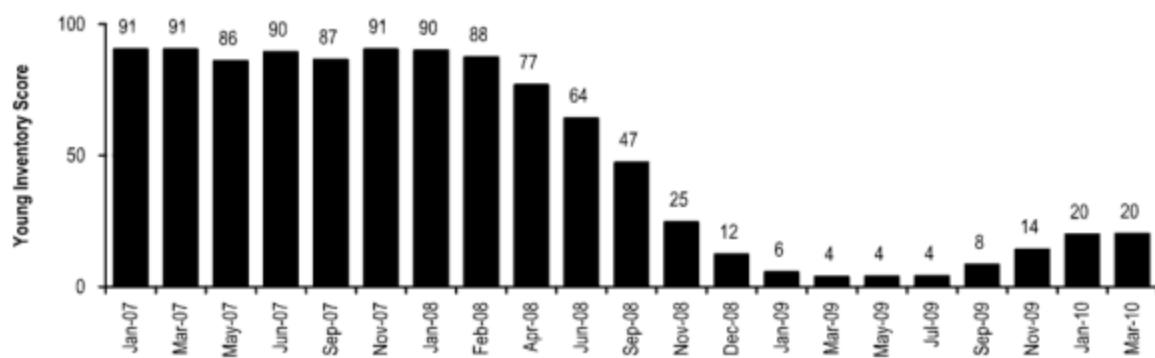
Chart 23: Indication of Young Inventory Levels, March 2010



Source: UBS Business Jet Survey #44

While our young inventory score reflects a drawdown from the recent peak, it still reflects a significant oversupply of high-quality, young used aircraft.

Chart 24: UBS Business Jet Survey Score—Young Used Inventory Levels

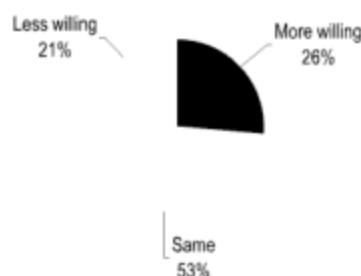


Source: UBS Business Jet Survey #1-44

## Willingness to Increase Inventories

In the next question, we asked, "Over the next month, will you be more or less willing to increase your inventory?" In this question, we again targeted broker/dealers, but in some cases, other participants also responded. The survey participants were asked to select "more willing", "same", or "less willing." Of the 76 responses (74 participants did not respond to this question), 26% indicated they would be more willing to take on inventory, while 21% indicated they would be less willing to take on inventory. The remaining 53% indicated no change in their willingness to take on inventory. This represents an improvement from our prior survey, in which 25% indicated they would be more willing to take on inventory, 26% indicated they would be less willing to take on inventory and the remaining 49% indicated no change in their willingness to take on inventory. We use this question to validate sentiment in the marketplace with regard to the near-term outlook.

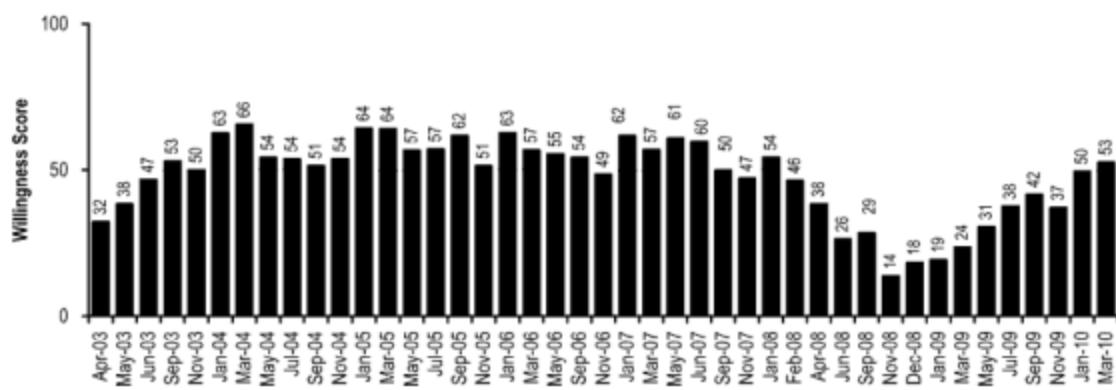
Chart 25: Willingness to Increase Inventory Levels, March 2010



Source: UBS Business Jet Survey #44

While this is the most volatile component of our survey, our willingness score increased 6% this time to 53, indicating respondents are more likely to add to inventories and reflective of increased confidence in near-term pricing/liquidity.

Chart 26: UBS Business Jet Survey Score—Willingness to Increase Inventory Levels

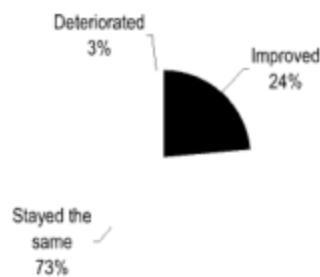


Source: UBS Business Jet Survey #1-44

## Customer Financing

In the next question, we asked, "Since our last survey in January, has the availability of customer financing improved, stayed the same, or deteriorated?" Of the 148 responses (two participants did not respond to this question), 24% indicated that customer financing conditions had improved, while 3% indicated that financing conditions had deteriorated. The remaining 73% indicated that financing conditions had stayed the same. These results are roughly in line with our prior survey.

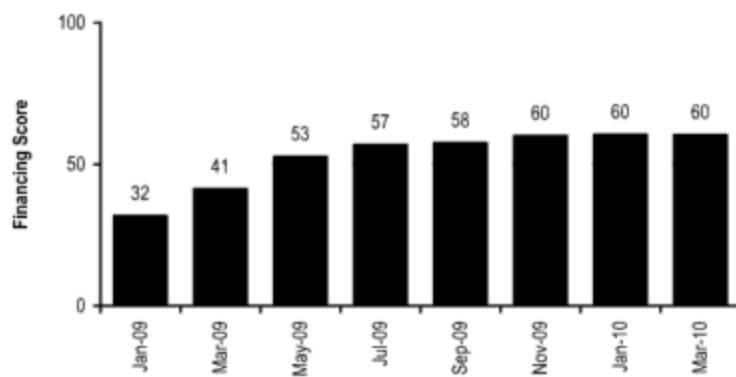
Chart 27: Financing Conditions, March 2010



Source: UBS Business Jet Survey #44

Our financing score came in at 60 this time, in line with our previous survey and indicating continued incremental improvement in financing availability.

Chart 28: UBS Business Jet Survey Score—Financing



Source: UBS Business Jet Survey #44

## **Commentary**

The following are selected comments from business jet professionals.

### **Current Market Conditions**

- Things are getting better, but we are not in a 'V' recovery, not even close.
- Still too many buyers only interested in buying at wholesale prices.
- We have seen a strong upturn, back to the levels of 18 months ago.
- International (Non-US) markets are holding a good level of interest and sales, reflecting an improved economy in some regions, Brazil for example.
- Flying has picked up 5-10% since this time last year.
- Best first quarter in years! Prices have been dropping over the last couple of weeks, which probably helps. Business is getting better by the day!
- Business is improving.
- The used market is approaching normal levels, although pricing remains highly depressed.

### **Interest & Inquiries**

- Call volume and interest are still rising, with most of our interest coming from overseas.
- There is activity in the marketplace but it seems to come in spurts. Other dealers have said the same thing to me. Things heat up, some sales take place and then everything goes quiet for a few weeks.
- We continue to observe a gradual improvement in demand.
- Interest levels continue to rise, but this has not yet translated into a significant improvement in sales.

### **Pricing**

- Buyers are seeking large discounts on repo purchases.
- We have been trading corporate jets in the global market since 1977 and this is the worst price collapse we have ever seen.
- Increasing rumors about heavily discounted new OEM product are negatively impacting pre-owned valuations.
- Gulfstream products remain the strongest; Challenger 604 and Citation Excel have improved; Citation X and Hawker 400/800 are still declining.
- Prices continue to erode.
- Prices are still low and buyers are looking for bargains, but there are plenty of buyers out there.

## **Financing**

- Liquidity has yet to fully return. The banks are hurting their asset value by failing to fund an orderly market again.
- Dealer floor plan financiers are nearly extinct.
- As the market works through inventory, credit will become more available. However, we may never see rates go as low as in the past.
- Financing is very difficult to find.
- Banks' client selection and underwriting scrutiny have never been more stringent.
- While lender scrutiny is relaxing and overall the financing environment appears to be opening up, availability remains depressed. We are still far from the conditions of 2006-07.
- Still very limited lending.
- Many banks and finance companies are more focused on reducing repo inventory than supporting buyers with competitive financing.

## **Transactions**

- It is a kind of hit or miss world for most. If the moon, sun and stars align and you have the right buyer, seller and airplane you can make a deal.
- Younger aircraft are selling, while older aircraft are taking forever to sell.
- In the last 30 days we have closed four transactions to retail buyers.
- The market has improved somewhat, but buyers are still a bit hesitant to pull the trigger. International buyers are only slightly more aggressive.
- We have three aircraft pending sale: one Challenger 601 and two Hawker 800s. All three are for retail customers with financing secured, and all are likely to close within the next 1-3 weeks, but these are VERY cheap compared to the rest of the market and compared to book value.

## **Outlook**

- I do not expect the market to fully recover for at least another 1-2 years.
- We may be running into a double-dip situation, similar to 1984-85.
- The traditional corporate flight department is awakening from its long winter nap, which should mean a much stronger 2010-11 than 2009.
- Until we see hiring resume, production increase, housing starts and sales on a steady incline, consumer spending increase and consumer confidence grow each month we will see more of the same in aircraft sales activity.
- The two major hurdles are the trade gap and credit availability / rates.

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### ■ Statement of Risk

The business jet market is cyclical in nature, largely driven by the general economic environment. Business jet manufacturers' earnings and cash flow are dependent on end-user demand, availability of customer financing, program execution and inventory management. Our estimates, ratings and price targets for both General Dynamics and Textron are subject to additional risks including poor program execution and government funding related to their defense and security businesses. Additionally, Textron faces liquidity risks related to its asset based lending businesses.

### ■ Analyst Certification

Each research analyst primarily responsible for the content of this research report, in whole or in part, certifies that with respect to each security or issuer that the analyst covered in this report: (1) all of the views expressed accurately reflect his or her personal views about those securities or issuers; and (2) no part of his or her compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed by that research analyst in the research report.

## Required Disclosures

This report has been prepared by UBS Securities LLC, an affiliate of UBS AG. UBS AG, its subsidiaries, branches and affiliates are referred to herein as UBS.

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### UBS Investment Research: Global Equity Rating Allocations

UBS 12-Month Rating	Rating Category	Coverage <sup>1</sup>	IB Services <sup>2</sup>
Buy	Buy	48%	40%
Neutral	Hold/Neutral	40%	35%
Sell	Sell	13%	26%
UBS Short-Term Rating	Rating Category	Coverage <sup>3</sup>	IB Services <sup>4</sup>
Buy	Buy	less than 1%	17%
Sell	Sell	less than 1%	67%

1:Percentage of companies under coverage globally within the 12-month rating category.

2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.

3:Percentage of companies under coverage globally within the Short-Term rating category.

4:Percentage of companies within the Short-Term rating category for which investment banking (IB) services were provided within the past 12 months.

Source: UBS. Rating allocations are as of 31 December 2009.

### UBS Investment Research: Global Equity Rating Definitions

UBS 12-Month Rating	Definition
Buy	FSR is > 6% above the MRA.
Neutral	FSR is between -6% and 6% of the MRA.
Sell	FSR is > 6% below the MRA.
UBS Short-Term Rating	Definition
Buy	Buy: Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.
Sell	Sell: Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.

## KEY DEFINITIONS

**Forecast Stock Return (FSR)** is defined as expected percentage price appreciation plus gross dividend yield over the next 12 months.

**Market Return Assumption (MRA)** is defined as the one-year local market interest rate plus 5% (a proxy for, and not a forecast of, the equity risk premium).

**Under Review (UR)** Stocks may be flagged as UR by the analyst, indicating that the stock's price target and/or rating are subject to possible change in the near term, usually in response to an event that may affect the investment case or valuation.

**Short-Term Ratings** reflect the expected near-term (up to three months) performance of the stock and do not reflect any change in the fundamental view or investment case.

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**UBS Securities LLC:** David E. Strauss; Cristina Fernandez; Darryl Genovesi. **UBS Securities Canada Inc:** Tasneem Azim.

## Company Disclosures

Company Name	Reuters	12-mo rating	Short-term rating	Price	Price date
<b>General Dynamics Corp.</b> <sup>16</sup>	GD.N	Buy	N/A	US\$76.94	23 Mar 2010
<b>Rockwell Collins Inc.</b> <sup>2, 4, 5, 6a, 6b, 6c, 7, 8, 16, 18a</sup>	COL.N	Buy	N/A	US\$62.85	23 Mar 2010
<b>Textron Inc.</b> <sup>2, 4, 6a, 6b, 6c, 7, 16, 18b</sup>	TXT.N	Neutral	N/A	US\$22.45	23 Mar 2010

Source: UBS. All prices as of local market close.

Ratings in this table are the most current published ratings prior to this report. They may be more recent than the stock pricing date

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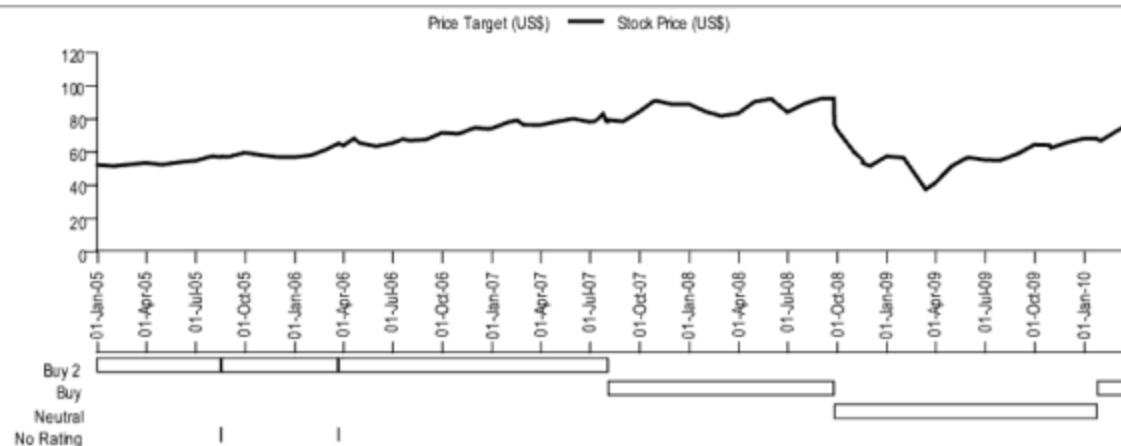
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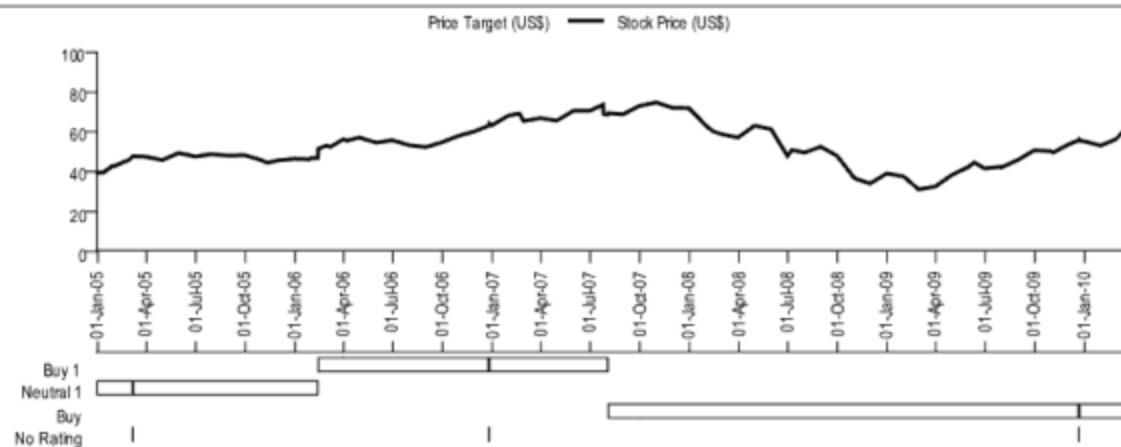
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#### General Dynamics Corp. (US\$)



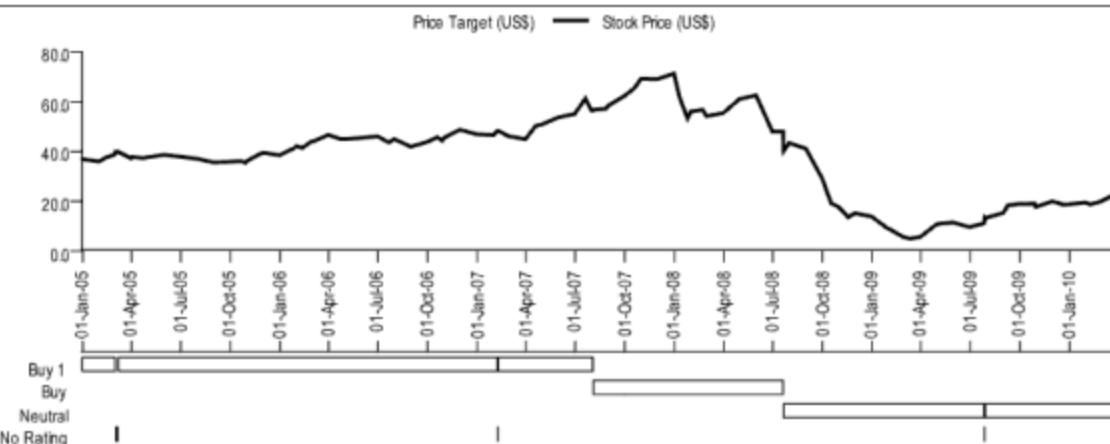
Source: UBS; as of 23 Mar 2010

#### Rockwell Collins Inc. (US\$)



Source: UBS; as of 23 Mar 2010

## Textron Inc. (US\$)



Source: UBS; as of 23 Mar 2010

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