

# Business Plan



Kitty Hawk Aeronautics

January 2010



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TRADING NAME ▶	Kitty Hawk Aeronautics	
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**DESCRIPTION OF THE BUSINESS** ▶ Kitty Hawk Aeronautics, Inc. (KHA) is a privately-held corporation that was founded in 1981 that is principally engaged in the research, design, development, manufacture of advanced technology systems and products. We serve both domestic and international customers with products and services that have defense, civil and commercial applications, with our principle customers being agencies of the U.S. government. The company has expanded its operations to five locations throughout the U.S. and employs over 1,200 people.

**MAJOR DEMOGRAPHIC AND ECONOMIC FACTORS** ▶ In 2009, 84% of our net sales were made to the U.S. Government, either as a prime contractor or as a subcontractor. Each of our business segments is heavily dependent on sales to the U.S. Government. Our U.S. Government sales were made to both Department of Defense (DoD) and non-DoD agencies. Sales to foreign governments (including foreign military sales funded, in whole or in part, by the U.S. Government) amounted to 13% of net sales in 2009, while 3% of our net sales were made to commercial and other customers.

**NATURE OF THE INDUSTRY** ▶ We rely heavily upon sales to the U.S. Government. Future sales from orders placed under our existing U.S. Government contracts are conditioned upon the continuing availability of Congressional appropriations. Congress usually appropriates funds on a fiscal-year basis even though contract performance may extend over many years.

**TRENDS IN THE INDUSTRY** ▶ KHA and other U.S. defense contractors have benefited from an upward trend in overall U.S. defense spending in the last few years. This trend continued with the President's budget request for fiscal year 2010, which reflected the continued commitment to modernize the Armed Forces and sustain current capabilities while prosecuting the war on terrorism. Future defense budgets and appropriations for our programs and contracts may be affected by possibly differing priorities of the new Administration, including budgeting constrains stemming from the economic recovery and stimulus plans.

**GOVERNMENT REGULATIONS** ▶ We must comply with and are affected by laws and regulation relating to the award, administration and performance of U.S. Government contract laws and regulations affect how we do business with our customers and, in some instances, impose added costs on our business. A violation of specific laws and regulations could result in the imposing of fines and penalties, the termination of our contracts, or debarment from bidding on contracts.



Specifically for DoD systems development work, all KHA developed systems are certified and accredited using the Defense Dept. DITSCAP procedure. All IT systems used in work for the federal government are certified using the NIST SP-800-53 procedures.

## OUR BUSINESS

### PRODUCTS & SERVICES

Primarily a manufacturer of high-quality avionics and telemetry components, KHA also provides production and after-market electronic assemblies and parts for aircraft and spacecraft. KHA serves all defense services, NASA, the FAA, and maintains business alliances with a number of leading aviation and aerospace firms.

Our business comprises of a number of core lines of business:

#### **Commercial Aviation Systems**

KHA supplies a complete line of avionics and cabin systems to manufacturers and operators of business aircraft and regional airlines. Products include integrated avionics and information systems as well as cabin management systems and cabin communication services.

#### **Defense Systems**

Our defense systems provide design, development, engineering and production of radio based communication systems to ensure the efficient operations of U.S. armed forces and government agencies.

#### **Space Systems**

Engaged in the design and development, engineering and production of key U.S. space programs. Including the delivery of the Ultra-Low-Latency Satellite Communication System, the telemetry system for Mars Lander IV Program and supporting Raytheon as subcontractor in delivering the Challenge Athena III Wideband Satellite Communication System.

#### **Research & Development**

As a sub-contractor to Boeing we support research and development activities aimed at driving avionic innovation both in the Space and Commercial Aviation sectors. Current R&D activities include the Next-Generation Space Shuttle Avionics Program and the development of a multi-function electronics busses for the Boeing Dreamliner.

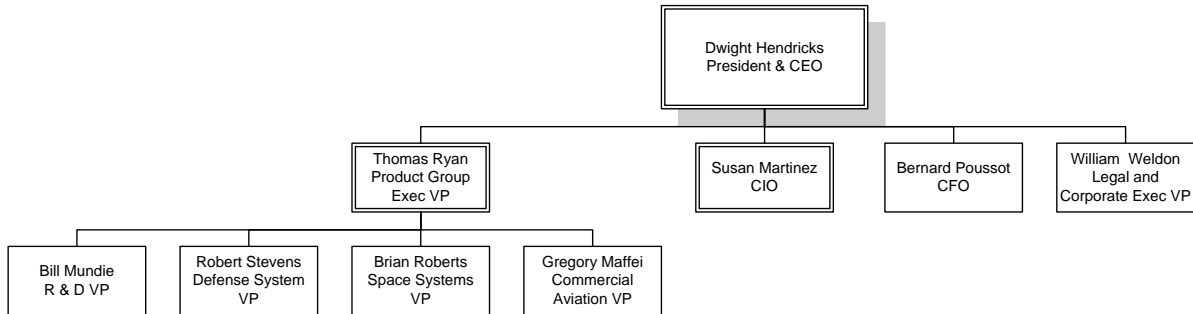
### PRICING AND DISTRIBUTION

We have gained a reputation for quality and delivery over many years and as such are able to charge a premium price for our services. Few other organizations have the expertise and manufacturing capabilities to deliver to the stringent quality constraints that our customers demand, or possess the R&D capabilities to drive forward new innovations.



VISION & MISSION ▶ The KHA vision and mission can be found [here](#), along with an associated SWOT analysis.

## Executive Officers



### Dwight Hendricks (President & CEO)

Dwight Hendricks joined KHA in 2005 after nearly 30 years with Boeing Aircraft Corporation. Mr. Hendricks successfully led two five-year strategic improvement programs that solidified and expanded KHA's lines of business and revenue streams.

### Thomas Ryan (Product Group Exec VP)

Thomas Ryan joined KHA in 2008 after nearly 10 years with Lockheed Martin Corp. Mr. Ryan has been has had a distinguished career and was awarded a prestigious contribution award from NASA for his role in the construction of the Space Shuttle.

### Bernard Poussot (CFO)

Bernard Poussot joined KHA in 2005 after nearly 23 years with Boeing Aircraft Corporation. Having already served under Dwight's leadership at Boeing as Finance Controller Bernard was an immediate choice to step up to the CFO role at KHA.

### William Weldon (Legal and Corporate Exec VP)

William Weldon is joined KHA in 2006 after 12 years practicing corporate law with leading law firm Fiddle, Grabbit and Swindle (New York).

### Susan Martinez (CIO)

Susan is KHA's first Chief Information Officer. Hired in 2004 to consolidate information technology (IT) resources and improve the value of IT support for line of business activities.



The alignment matrix below outlines the relationship between the current/in-flight business activities and the associated high level business strategy. For a full review of the KHA business strategies see the Medium Level View of the [Strategic Initiative](#).

## Business Strategy to Activity Alignment for 2010

Business Activity	Higher Strategy	Lead LOB	Detailed Description
Contract Management System	Costs Improve Value	Contracts & Legal	Implement a performance-based contracting approach that uses standard on-line templates and a document tracking/correspondence control system
Create Asia & Europe Operations	Establish New LOB	Commercial Aviation Systems	Establish a customer base in Asia/Europe for the Commercial Aviation line of business
Create General Aviation Division	Establish New LOB	New Division	Establish a "General Aviation Systems" line of business
Deliver Challenge Athena III Satellite Comms System	Increase Profits < 7% Per Year	Space Systems	Support Raytheon as subcontractor in delivering the Challenge Athena III Wideband Satellite Communication System
Deliver FA-18 Block-III VHF Radios	Increase Profits < 7% Per Year	Defense Systems	Deliver FA-18 Block-III VHF radios to Naval Aviation Systems Command
Deliver M53J Pave-Low IV Tactical Comms Radio	Increase Profits < 7% Per Year	Defense Systems	Deliver the MH53J Pave-Low IV Tactical Communications Radio for the USAF
Deliver Mars Lander IV Program	Increase Profits < 7% Per Year	Space Systems	In partnership with the Jet Propulsion Lab, develop the telemetry system for the Mars Lander IV Program
Deliver USAF Satellite Comms System	Increase Profits < 7% Per Year	Space Systems	Deliver the recently-awarded USAF Ultra-Low-Latency Satellite Communications System, and migrate functionality and data from the legacy USAF GeoTalk System
Electrical Harness Production Upgrade	Increase Profit < 7% Per Year	Commercial Aviation Systems	Improve electrical harness product line quality and cost competitiveness
Establish Activity Based Cost Accounting	Costs	Finance & Administration	Control costs by establishing activity based cost accounting in all lines of business



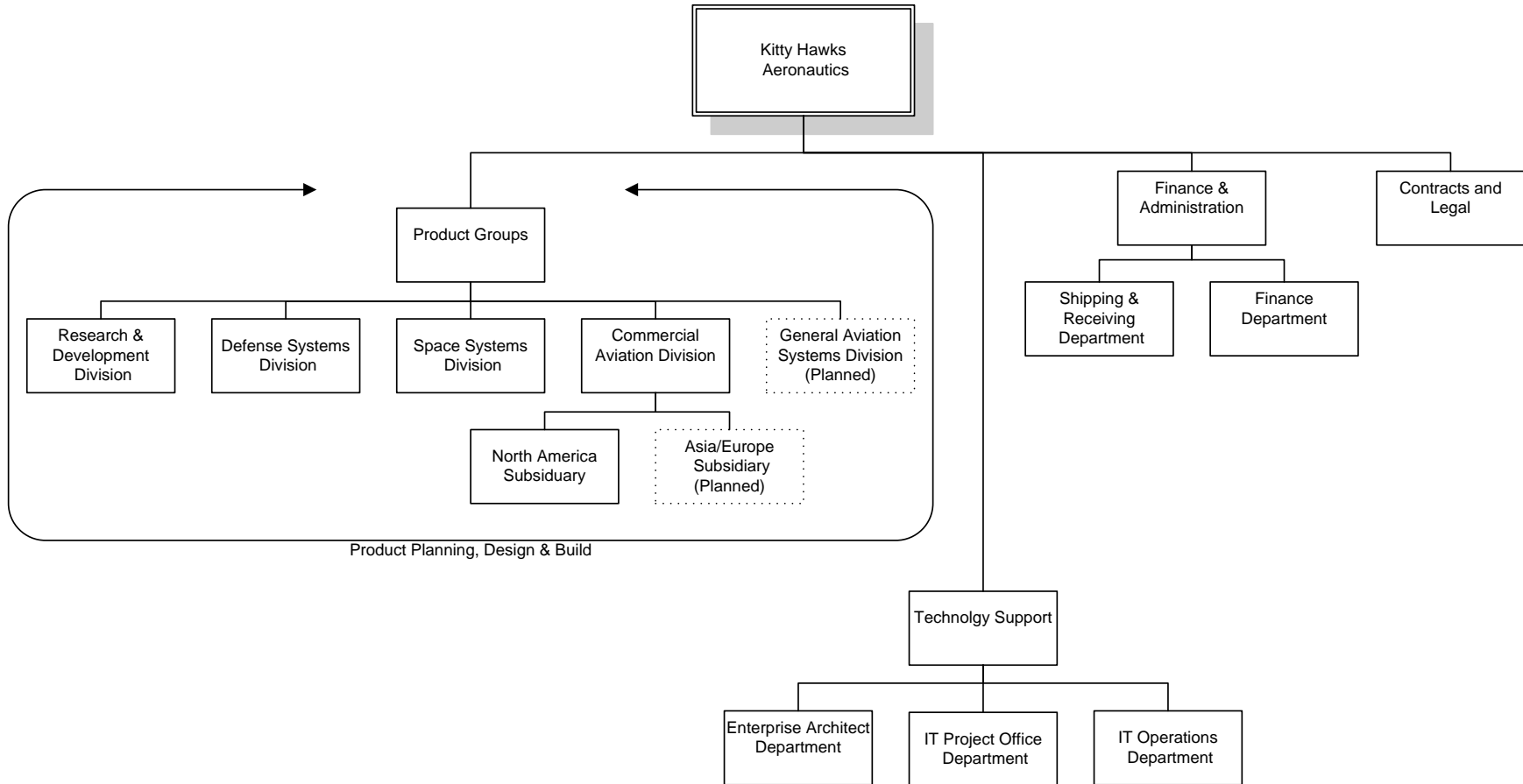
Business Activity	Higher Strategy	Lead LOB	Detailed Description
Establish EA Program	Improve Value	Information Technology	Establish and maintain an enterprise architecture program and on-line repository of actionable EA information
Establish Knowledge Warehouse	Improve Value	Information Technology	Establish a Knowledge Warehouse for the KHA enterprise
Expand Avionics Product Line	Increase Profits < 7% Per Year Expand Business	Commercial Aviation Systems	Expand avionics product line to include Boeing MD-80
Expand IT-COE	Improve Value	Information Technology	Expand the IT Common Operating Environment (IT-COE) to host all front-office and back-office applications at each company location, and expand LAN/WAN capabilities
Expand San Diego Shipping Facility	Increase Profits < 7% Per Year Expand Business	Shipping and Receiving	Expand the Warehouse and Shipping Department at the San Diego facility
Finance/Contract Integration	Improve Value Costs	Contracts & Legal	Integrate contracting information with finance and accounting information.
Finance/Sales Reporting System	Improve Value Costs	Finance & Administration	Integrate financial information with sales and warehouse data, and establish access controlled data marts that push pre-formatted reports daily.
IT Capital Planning Program	Improve Value	Information Technology	Establish an IT capital planning program to improve the value of investments in IT
IT-COE Security Solution	Improve Value	Information Technology	Develop and implement a follow-on IT Security solution for the IT-COE
Lexus/Nexus Upgrade	Improve Value	Contracts & Legal	Upgrade legacy Lexus/Nexus on-line legal library system, make available in San Diego
New Component Facility	Expand Business Increase Profit < 7% Per Year	Commercial Aviation Systems	Roll-out a new Commercial component manufacturing plant in San Diego, California
R&D for Boeing Dreamliner	Expand Business	Research & Development	Develop multi-function electronics busses for the Boeing Dreamliner



Business Activity	Higher Strategy	Lead LOB	Detailed Description
R&D for NGSSAP	Expand Business	Research & Development	As a subcontractor to Boeing, support research and development activities for the Next-Generation Space Shuttle Avionics Program (NGSSAP)
Support Delivery of Deepwater Cutter Radios	Increase Profits < 7% Per Year	Defense Systems	Support Northrop Grumman outfitting of USCG Deepwater Cutter UHF/VHF radios
Warehouse Handling Efficiencies	Increase Profits < 7% Per Year	Shipping and Receiving	Reduce average warehouse handling time by 10% per year for 2008-2010
KHA Customer Relations in 2010	Promote Cultural Change Expand Business	Architecture & Planning	This is a projected future scenario based on our team's SWOT analysis. The focus for this future scenario is KHA Customer Relations. For a detailed description see the high level view of the <a href="#">strategy sub architecture</a> .



Kitty Hawk Aeronautics continue to invest in the future and this is evident by our plans to grow the organisation through our expansion into the Asia/Europe market and the formation of a General Aviation Systems line of business.





GOVERNMENT AND DEFENSE MARKET TRENDS

**U.S. Government Business**

In these times of unprecedented economic uncertainty and market turmoil, developing and implementing spending, tax and other initiatives to stimulate the faltering economy is at the forefront of the U.S. Government's activities. We expect the Obama Administration's decision regarding defense, homeland security, and other federal spending priorities, and the Congress' reaction to the Administration's proposals, to be balanced with the cost and impact of economic stimulus initiatives, particularly in the longer term.

Although we believe some priorities will change, many of the investments we have made are focused on aligning our businesses to address what we believe are the most enduring national imperatives and critical mission areas. But the possibility remains that one or more of our programs could be reduced, extended, or terminated as a result of the Administration's assessment of priorities.

**Defense Business**

The DoD has, for the past eight years, focused on sustainment of current military capabilities and modernization of our Armed Forces to deter and defeat current and future threats.

Given the current economic downturn initiatives to address economic stimulus will compete with other national priorities, such as defense and homeland security. In this period of transition, we expect the new administration to look broadly across current programs and examine existing resources as part of its assessment of national priorities.

Although the ultimate size of future defense budgets remains uncertain, current indications are that overall defense spending will continue to increase over the next few years, albeit at a lower rates of growth. The DoD base budget for fiscal year 2010 provided mid-single-digit growth above prior year levels. Current estimates for the budget for fiscal year 2011 provide for growth of about 2% to 3% over 2010 levels. The Administration's assessment likely will include focus on the level and composition of supplemental budget requests going forward.

Although Congress has continued to express concern about the size of supplemental budget requests, funding for ongoing operations has not been significantly curtailed by Congress to date. We expect to see continuing pressure to reduce funding requests.

IMPLICATIONS OR RISK FACTORS

We are exposed to risks associated with U.S. Government contracting, including technological uncertainties, dependence on fewer manufacturing suppliers, and obsolescence, as well as Congressional appropriation and allotment of funds each year. Many of our programs involve the development and application of state-of-the-art technologies aimed at achieving challenging goals. As a result, setbacks, delays and cost growth and product failures can occur.



PLANNED  
RESPONSE

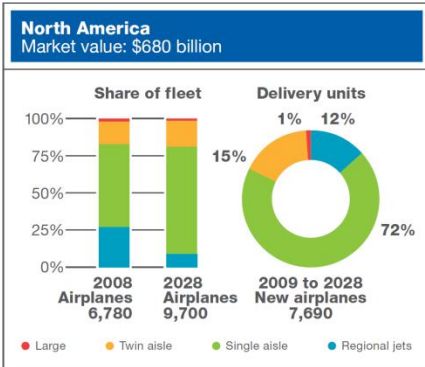
▶ To mitigate these risks we are focussing our efforts on mission critical projects that have a high level of support by both the current Government Administration and Congress.

We are also seeking to aggressively reduce operating costs for all divisions through the establishment of activity based accounting in all our lines of business. Our supporting [services model](#) will play a major role in the in reducing operating costs by providing a consistent framework across the organization.

Further cost controls will be realized through investments aimed at improving the integration of finance with both our sales and contract systems. This will provide management with greater insight when making business decisions and ultimately maximize our return on investments.



COMMERCIAL AVIATION MARKET TRENDS



## NORTH AMERICA

### Travel markets

North America’s well-developed internal market is projected to grow at a modest rate of 2.5 percent over the next 20 years. Longer-haul international services will continue to achieve higher growth rates, driving strong demand for efficient twin-aisle airplanes such as the Boeing 787 and 777.

### Airplane replacement

Slow growth in short-haul markets means that the majority of airplane deliveries (over 60 percent) will be for replacement. Fuel-thirsty existing fleets continue to age. By the year 2014, more than 700 passenger airplanes, mostly single-aisle types, will be at least 25 years old, unless significant numbers of airplanes are retired. The broad capabilities of newer generation airplanes, such as today’s 737 family, provide economic incentives to replace a wide spectrum of older types, including the large number of MD-80s and the oldest 737s, 757s, and A320s in the existing fleet.

### Consolidation and new entrants

Some industry observers see the recent merger of two of the region’s top airlines as a sign that there is room for further industry consolidation, which would have a dramatic effect on the structure of the industry. Consolidation typically creates economies of scale, bringing revenue and cost improvements from elimination of redundant services and excess capacity. Any resulting realignment of major airline route networks would provide opportunities for smaller airlines and startups to fill the voids created by the withdrawal of network carriers. New entrants will benefit from access to lightly utilized facilities and a customer base revitalized by new services and innovative product offerings.

### Larger regional jets

North America’s airlines are reshaping their regional fleets to use larger-sized regional jets and small single-aisle airplanes. The larger airplanes cost less to operate per seat and offer greater revenue potential. We project demand for more than 1,600 large regional jets and small single-aisle airplanes over 20 years. Fuel costs and intense competition have taken a heavy toll on small RJ economics. Many relatively young RJs are being removed from fleets as network airlines cope with an unforgiving business environment. We forecast only 140 new deliveries in this category, all of them to replace older airplanes. RJs will account for only 9 percent of the fleet in 2028, compared to over 27 percent today.

## EUROPE/ASIA

### Strength in Time

Despite current market conditions, the long-term forecast for airplanes in Europe/Asia has increased a little this year. So far, the airline market





- COMPETITION** ▶ The range of products and services provided by Kitty Hawk Aeronautics results in competition with other aerospace, defense and technology companies, as well as with numerous smaller competitors. The principle factors of competition include technical and management capabilities, the ability to develop and implement complex, integrated systems, affordability and past performance. Program requirements frequently result in the formation of teams such that companies teamed on one program are competitors for another, especially in our defense system line of business.
- COMPETITORS' STRENGTHS AND WEAKNESSES** ▶ Our competitors are new to market and are still building their research, design and manufacturing capabilities. But they do have the advantage of lower operating cost.
- COMPETITIVE ADVANTAGE** ▶ We have a proven track record within our markets and have build credibility, both in the commercial and government sectors in the delivery of innovative systems within budget and on-time. With a focus on reducing our operating cost, maximizing the investment in IT technologies, while continuing healthy growth, we intend to ensure our competitive advantage.



The global economy is emerging from the worst recession since the great depression of the 1930 and that is reflected in the Business Cycle diagrams below. The cycles for our North America analysis show a far worse and continued depression than the Europe and Asia regions. Further underlining the investment opportunities in the European and Asian markets.

Reference the mid level business processes view for a more detailed analysis.

### North America Market Business Cycles

Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
4177	4444	4331	4331	4331	4331	4331	4331	4331	4331	4331	4331

Annual Total Forecast 50570

Secular Trend Factor 95%

### Europe and Asia Markets Business Cycles

Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
5569	5569	5569	5569	5569	5569	5569	5569	5569	5569	5569	5569

Annual Total Forecast 67427

Secular Trend Factor 108%



## Capitalization Summary

At December 31, 2009, we held cash and cash equivalents of approximately \$2.2 billion and short-term investments of \$61 million. Our long-term debt, net of unamortized discounts, amounted to \$3.6 billion. As of the end of 2009, our long-term debt bears interest at fixed rate and is in the form of debentures.

Through our debt repayment activities, our long-term debt balance has declined \$2.4 billion over the last five years from \$6.2 billion at December 2004. Our debt-to-total capital ratio was 57% at 31 December, 2009, up from 31 % at December 31, 2007.

Return on invested capital (ROIC) improved by 30 basis point during 2008 to 21.7%.

At December 31, 2008, we had in place a \$1.5 billion revolving credit facility with a group of banks which expires in June 2013. There were no borrowings outstanding under the facility at December 31, 2009. Borrowings under the credit facility would be unsecured and bear interest at rates based, at our option, on the Eurodollar rate or a defined Base Rate.

We have agreements in place with backing institutions to provide for commercial paper. There were no commercial paper borrowings outstanding at December 31, 2009. If we were to issue commercial paper, the borrowings would be supported by the \$1.5 billion credit facility.

We actively seek to finance our business in a manner that preserves financial flexibility while minimizing borrowing costs to the extent practicable.



## Financial Strategy

Between September 2007 and June 2009, KHA adopted a series of Principles and Policies that form a Multi-Year Financial Strategy. A Multi-Year Financial Strategy Committee was formed in May 2008. The mandate of the Committee was to devise a Multi-Year Financial Strategy that would respond to a number of objectives. The objectives were:

- To understand the baseline
- To anticipate future operating, capital and reserve requirements
- To reasonably predict tax rates and debt requirements far enough in advance to make decisions in an appropriate time frame
- To develop targets for services with clear links between costs, services and financial capacity

A four phased approach called "Taking Care of Business" was presented in September 2008. The strategy included the articulation of a healthy financial position for KHA, a plan for implementation and a time frame.

1. To develop a basis for financial responsibility in future decision-making, the KHA board unanimously adopted nine Principles of Financial Management in December 2009. The Principles provide a framework for business planning, operational effectiveness and discipline and restraint in spending and funding. They are:
2. Adhere to generally accepted accounting principles, and the Objectives of Financial Statements as recommended by the Public Sector Accounting and Auditing Board.
3. Make decisions based on sound business planning and a full understanding of the financial implications of operating each service.
4. Each division shall develop a Business Plan that includes a forecast of operating and capital requirements for the period of at least the next three fiscal years. The plans will be rolled out into a comprehensive municipal plan as part of the Multi-Year Financial Strategy (MYFS). These Business Plans will be updated annually.
5. Business cases for changes to divisions and major capital projects will state the impact on the MYFS Base Model (Tax increase, fee for service, budget reduction, operating impact, etc.).
6. Set budgets which are based upon reasonable, supportable and complete assumptions that the Board and management believe reflect the most probable set of economic conditions and planned courses of actions. To be reasonable, these assumptions need to be consistent with the business plans of the service.
7. KHA will take a double entry approach to additional expenditures in any budget year. To add an expenditure, another budgeted expenditure has to be removed. Expenditures arising during the year, but not provided for in the approved budget, must either have a positive or zero net effect on KHA's annual financial outcome.

As well as provide a framework for business decision-making, the Strategy needed to provide a mechanism for predicting future revenue and expenditure patterns. A computer model has been developed. By setting a series of economic and demographic assumptions, detailing 27 cost drivers, 30 service drivers, and 137 services, and incorporating assumptions regarding tax rates, reserves, capital debt and other fiscal factors, the model is able to estimate future revenues and



expenditures. Since the adoption of the Multi-Year Strategy in June 2009, the model has been used periodically to assist in predicting future financial choices that KHA may have.

The implications of adopting a Multi-year Financial Strategy require a focus on continuing work plans that will integrate financial factors into KHA decision making.



## Current Financial Status Summary

### Kitty Hawk Aeronautics Consolidated Statement of Earnings

<i>In millions</i>	<i>Year ended December 31,</i>		
	<b>2009</b>	2008	2007
<b>Net Sales</b>			
Products	\$34,809	\$35,267	\$33,863
Services	7,922	6,595	5,757
	<b>42,731</b>	41,862	39,620
Cost of Sales			
Products	30,874	31,479	30,572
Services	7,147	5,874	5,118
Unallocated Corporate Costs	61	275	496
	<b>38,082</b>	37,628	36,186
	<b>4,649</b>	4,234	3,434
Other Income (Expense), Net	482	293	336
<b>Operating Profit</b>	<b>5,131</b>	4,527	3,770
Interest Expense	341	352	361
Other Non-operating Income (Expense), Net	(88)	193	183
Earnings Before Income Taxes	4,702	4,368	3,592
Income Tax Expense	1,485	1,335	1,063
<b>Net Earnings</b>	<b>\$ 3,217</b>	\$ 3,033	\$ 2,529

### **Knowledge Manage Plan**

It is important that our investment in information is correctly and consistently managed throughout the organization. Any initiative must comply with the newly created [Knowledge Management Plan](#). Compliance will be governed and audited throughout the year.

### **Safe & Secure Policy**

Safety and security remain a critical concern for the organization and the updated KHA [Security Plan](#) reflects this priority.

## Kitty Hawk Aeronautics Inc – Partners and Associates

U.S. Government Department of Defense

*Air Force*

*Navy*

NASA Jet Propulsion Labs

NASA Mission Control

Boeing Aircraft Corporation

Northrop Grumman

Raytheon