



Industry Trends

Carlos Gomes (416) 866-4735
carlos_gomes@scotiacapital.com

Aerospace Cycle Remains Intact

The upturns in civil aerospace and defence demand have led to accelerating production and earnings for the global aerospace industry over the past several years. However, spiraling fuel prices have recently led to large capacity reductions in the United States and elsewhere. Investors have also become concerned that carriers will begin to cancel or defer delivery of new aircraft.

While large U.S. 'legacy carriers' may postpone fleet renewal due to financial problems, 90% of the industry's backlog is with healthier non-U.S. carriers. Furthermore, the new aircraft are at least 30% more fuel-efficient than older generation planes, and will be key to restoring the industry's financial health.

Despite moderating global economic growth and capacity reductions, orders for more fuel-efficient aircraft continue to advance, climbing to a record in 2007 and posting an additional 43% y/y advance through May 2008. Combined Boeing and Airbus have a record order backlog of more than 7,000 planes, leading to rising production over the next several years.

Key Points

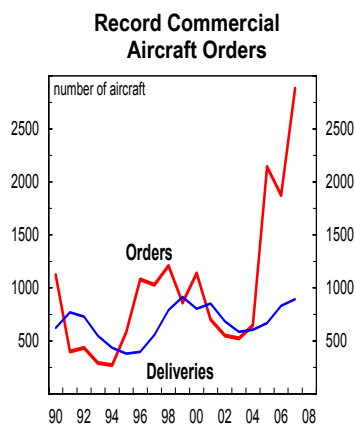
Strengths

- Record backlog for commercial & business jets
- Increased demand for fuel efficiency
- Solid orders from overseas buyers

Weaknesses

- Risk of intensifying economic weakness globally
- Credit crunch and high fuel costs could trigger financial restraint
- Competition from cheaper producers overseas

Strong Earnings Outlook



The aerospace sector continues to deliver strong earnings gains, despite declining overall earnings for companies in the S&P500. This reflects the fact that commercial aerospace is a late-cycle business with an expanding order backlog. While many S&P500 companies have reduced guidance in recent months as the U.S. economy has lost momentum, earnings for aerospace companies will accelerate over the next several years as aircraft production ramps up.

Return on shareholders' equity for aerospace companies continues to improve, climbing to 26% in mid-June — from just over 18% a year earlier, and more than double the return for the overall S&P500 index. In contrast, the return on shareholders' equity for S&P 500 companies peaked at 18% in August 2007 and has since fallen to 11.5% — the lowest level since late 2003.

Record Business Jet Deliveries

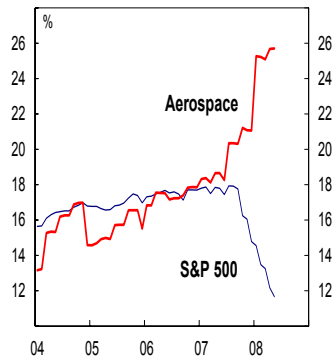
Business jet shipments climbed 28% y/y in 2007, surpassing 1,000 units for the first time on record. Based on publicly indicated production rates by various manufacturers, 2008 is expected to be

Scotia Economics

Scotia Plaza 40 King Street West, 63rd Floor
Toronto, Ontario Canada M5H 1H1
Tel: (416) 866-6253 Fax: (416) 866-2829
Email: scotia_economics@scotiacapital.com

This Report is prepared by Scotia Economics as a resource for the clients of Scotiabank and Scotia Capital. While the information is from sources believed reliable, neither the information nor the forecast shall be taken as a representation for which The Bank of Nova Scotia or Scotia Capital Inc. or any of their employees incur any responsibility.

Return On Shareholders' Equity



another record year for business jet deliveries. Bombardier is a leader in the business jet market with a 20% market share, up from a low of 13.5% in 2003. The company received a record 452 orders for business jets last year, a 64% surge from 2006. The company expects demand to remain strong through the next decade, leading to nearly 10,000 industry-wide deliveries by 2026.

There is some concern that weakening economic conditions in the United States will reduce business jet demand, as the business jet cycle is correlated, with a one- to two-year lag, with corporate profitability. However, the industry's backlog currently exceeds two years and its order books are now less exposed to U.S. customers. For example, Bombardier indicates that its U.S. orders now account for only 30% of its total sales, down from 70% four years ago. Most of the order growth is coming from Asia, Russia and Europe. This broadening of demand should enable business jets to weather the current U.S. economic downturn.

Aerospace accounts for roughly 20% of Canada's transportation equipment industry — motor vehicles & parts, aerospace, rail and ship building — and the sector has been advancing at a double-digit pace since late 2007, providing a partial offset to the ongoing weakness in Canada's motor vehicle industry. Several Canadian aerospace companies are suppliers to either Boeing or Airbus.

Increased Regional Jet Competition

While demand also remains strong for regional jets, the coming year will see new entrants in the market, and soaring fuel prices could limit orders. The first flights for the Sukhoi Superjet 100 and Chinese

ARJ21-700 are set for the first half of 2008.

Bombardier's board has approved the go ahead for the CSeries aircraft due to interest from several airlines, including some from Europe and the Middle East. However, management has indicated that production of the CSeries may not occur in Canada, due to rising costs associated with the sharp appreciation of the Canadian dollar.

Demand for helicopters also remains strong, with a major manufacturer seeing roughly a 40% surge in its backlog after recent trade shows in Singapore and Houston. Demand is being supported by offshore oil and gas development as well as fleet replacement.

Airline Traffic Begins to Moderate

Airline traffic has held up well in the first half of 2008, but we expect traffic growth to moderate to about 3% in 2008 from 6% last year. The United States and Western Europe will account for most of the slowdown. Industry profitability will also be dampened by high fuel costs — now the largest operating expense — accounting for more than 35% of overall costs, up from a normal 10 to 15%. While lower profits are expected to lead to a fall-off in aircraft orders later this year, order activity has continued to surge in early 2008.

In Canada, traffic growth remains at 6% y/y through May — in line with the average of the past three years — with growth in both domestic and international markets. However, in Europe — especially in the U.K. — major carriers are experiencing a significant slowdown, and are losing share to low-cost carriers.

Double-Digit U.S. Defence Spending Continues

The 2009 U.S. budget calls for a 12% increase in defence spending — in line with the double-digit average annual increase since 2001. The budget focuses on the continued war on terrorism and 'developing future combat capabilities', which supports long lead time, high-technology programs.

Procurement of aircraft totals US\$32.4 billion in FY09 and accounts for 32% of the overall procurement budget. This includes the KC-X tanker contract valued at US\$35 billion over 15 years, which was originally awarded to Airbus and Northrop Grumman. However, weapons and tracked vehicles are the fastest-growing areas of defence spending, increasing by 18% in FY09.

Transportation Indicators

| | 2004 | 2005 | 2006 | 2007 | 2008F |
|--|-------|-------|-------|-------|-------|
| AIR TRAFFIC | | | | | |
| Global RPKs (revenue-passenger-kms, % ch) | 14.9 | 7.0 | 5.9 | 5.9 | 3.0 |
| Cargo FTK (freight tonne kms, % ch) | 7.9 | 0.4 | 3.9 | 4.1 | 3.5 |
| AIRLINE PROFITS (US\$bn) | | | | | |
| Global | -5.6 | -4.1 | -0.5 | 5.6 | -2.3 |
| North America | -9.1 | -6.7 | -2.7 | 2.7 | -3.0 |
| U.S. DEFENCE BUDGET (FY, % ch)* | | | | | |
| Procurement & R&D | 4.9 | 1.7 | 6.7 | 9.9 | 4.7 |
| Aircraft Procurement | 11.6 | 2.6 | 24.8 | -11.6 | 9.8 |
| GLOBAL GDP Growth, (% ch) | 5.3 | 4.4 | 5.0 | 4.9 | 3.7 |
| WTI OIL PRICES (US\$/bbl) | 41.40 | 56.56 | 66.22 | 72.32 | 125 |

*FY starting in October of each year.