

## ***Mission control***

Second-quarter 2012 aerospace  
and defense industry mergers  
and acquisitions analysis



**Scott Thompson**  
US Aerospace &  
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### To our aerospace and defense readers

Welcome to the latest edition of *Mission control*, PwC's analysis of mergers and acquisitions in the aerospace and defense sector. In this report, you'll find an overview of M&A in the sector during the second quarter of 2012, as well as our expectations for deal activity in the near future.

PwC analysts are monitoring several trends expected to affect the values and locations of deals in the A&D sector:

- Overall activity in the sector increased during the second quarter of the year. Acquirers remained largely focused on smaller deals, with less interest in large deals primarily due to the looming sequestration in the US, which led to substantial uncertainty in the largest defense budget globally and made it challenging to choose and value potential targets.
- US participation in M&A decreased, as defense companies in the United States were most directly concerned with the impact of sequestration, and the balance of deal making shifted more toward emerging markets, in particular the BRICs. Aerospace targets, many of which benefit from a relatively high growth outlook compared to defense, drove more of the M&A totals.
- Defense companies diversified more into small industrial businesses. Many such deals had small or undisclosed values and have not received a lot of attention, but the targets generally were associated with such areas as government services, information technology, and communications.
- The difference in aerospace and defense growth outlooks have generally flowed through to valuations for these respective targets, with aerospace companies tending to earn a premium valuation over defense companies.

Deal totals are not expected to increase significantly throughout 2012 unless there is greater clarity on the US defense budget. One possible scenario, particularly given the upcoming US presidential election, is that activity will continue at the current pace, with the market largely driven by aerospace and small defense/industrial deals.

We're pleased to present the second-quarter 2012 edition of *Mission control* as a part of our ongoing commitment to provide a better understanding of M&A trends and prospects in the industry.

Sincerely,

A handwritten signature in black ink, appearing to read "Scott".

## Perspectives:

### Thoughts on deal activity in the second quarter of 2012

Welcome to *Mission control*, our quarterly analysis of M&A activity in the aerospace and defense sector. On the heels of a record year for A&D deals in 2011, the pace of M&A activity in 2012 remains slow, with only \$5 billion in deals for the first half of the year. The pace of activity is the lowest in more than a decade, even lower than 2009, when the effects of the financial crisis took hold on the global economy. One impediment to deal activity is the uncertainty about US defense budgets and programs resulting from the unresolved US sequestration issue. Accordingly, it is difficult for buyers and sellers to agree on value when there is so much uncertainty about the future cash flows of the business. These circumstances have resulted in a nearly complete absence of large deals involving any companies in the defense sector.

This low level of activity could continue until the sequestration issue is resolved and there is more certainty about defense budgets and programs. Such resolution is not expected before the November elections, and there is likelihood that the sequestration deadline could be extended to give lawmakers additional time to reach agreement. If the deadline is extended and uncertainty remains, the weak M&A environment could extend well into 2013.

Once sequestration is resolved, activity could pick up. Declining defense budgets will lead to economic pressures that can result in a wave of consolidation in the industry. Therefore, a combination of economic forces and pent-up demand could drive robust activity once sequestration is resolved.

Three deals above \$500 million were reported in the first half of the year: two in space and one in aerospace. Two additional large deals will be reported in the third quarter: the sale of Volvo Aero to GKN for \$1 billion and the sale of Rocketdyne to Gencorp for \$550 million. Beyond the size of deals, the macro issue of sequestration is contributing to several other trends in the market. US participation is down, as defense companies in this market are most directly

affected by this specific budget issue, and the balance of deal-making is shifting more toward BRICs specifically and emerging markets more generally. Another trend is that aerospace targets, many of which benefit from a relatively high growth outlook compared to defense, are driving more of the M&A totals. If supplier consolidation can improve financial strength in order to support the aerospace production ramp-up, this segment could substantially contribute to new deals in the sector.

Another trend is that defense companies are diversifying more into small industrial businesses. This provides an interesting contrast from some of the recent industrial/defense conglomerate breakups, most notably the ITT defense spin-off in 2011. Many of these deals have small or undisclosed values and have not received a lot of attention, but the targets generally fall into areas such as government services, information technology, and communications.

The difference in aerospace and defense growth outlooks have generally flowed through to valuations for these respective targets, with aerospace companies tending to earn a premium valuation over defense companies. It is also interesting that, while cash levels remain high, stock is being used more often to fund deals. This could be related to divergence in valuation as deal flow involves more aerospace acquirers. Unsolicited bids have also become more popular, and high cash levels and low overall valuations may support the use of this technique going forward.

As we enter the second half of 2012, deal totals may not pick up significantly without more clarity over the US defense budget. If sequestration goes into place, and the general trend of pressure on defense budgets in Western nations continues, it is more likely that calls for significant defense consolidation will become prominent. However, one likely scenario for the remainder of 2012 is that deal activity continues at the current pace, with aerospace and small defense/industrial deals driving the overall market.

## Deal totals

Following a historically weak first quarter, deal volume has rebounded to a level more in line with the norm of the last three years. However, deal value remains weak with the market shifting back toward smaller deals after a robust 2011. The single biggest headwind is probably the uncertainty in the defense outlook.

The United States, which accounts for roughly 40% of global defense spending, faces the potential for sequestration, which would lead to an incremental \$500 billion in spending cuts starting next year on top of \$487 billion in cuts already planned. There is uncertainty involved in the extent of these reductions and how they will be implemented. This is making it difficult to appropriately

reposition existing operations, let alone begin to engage in larger-scale, more transformative M&A.

US entities are most directly impacted by this issue, and this has been reflected in their relative decline in participation in the aerospace and defense deal market as it pertains to both volume and value. With the presidential election looming in November, the sequestration issue is unlikely to resolve quickly and should remain an impediment to large defense M&A over much of the remainder of the year. Defense transactions are instead likely to continue to focus on small-scale expansions into the few areas of growth in defense spending, as well as some diversification into industrial businesses as addressed later in this report.

### Quarterly aerospace and defense deal activity

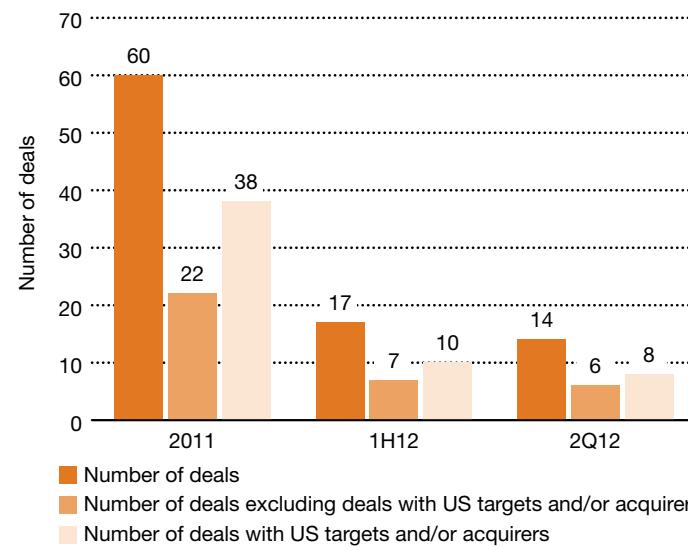
Measured by number and value of deals worth \$50 million or more (3Q09–2Q12)

	2009		2010				2011				2012	
	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q
<b>Number of deals</b>	11	12	10	13	17	26	22	15	11	12	3	14
<b>Total deal value (\$ bil.)</b>	3.8	5.1	5.7	6.3	5.1	6.4	12.6	6.2	20.3	3.5	1.3	3.7
<b>Average deal value (\$ bil.)</b>	0.3	0.4	0.6	0.5	0.3	0.2	0.6	0.4	1.8	0.3	0.4	0.3

## Deal categories and acquirer types

### Deal activity by number of deals

Measured by number of deals worth \$50 million or more



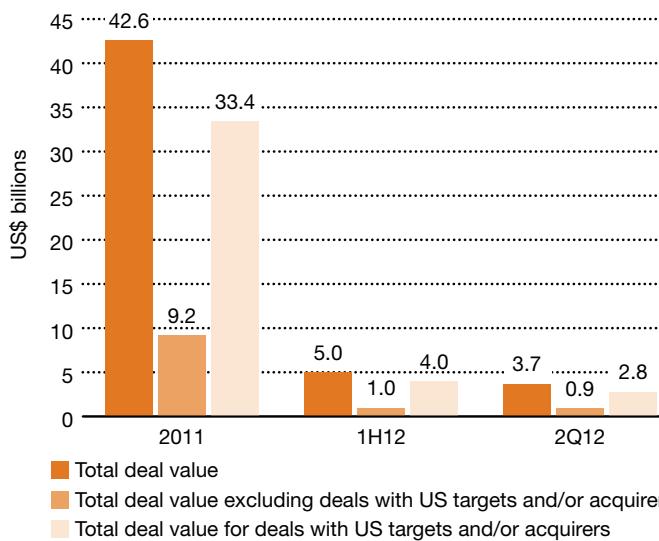
### Deal activity by average deal value

Measured by value of deals worth \$50 million or more



### Deal activity by total deal value

Measured by value of deals worth \$50 million or more



Deals by aerospace and defense category have shifted toward aerospace targets so far this year. There are several motivations for these deals, including a desire to benefit from relatively high growth in commercial aerospace and a need to consolidate the supply chain in order to ensure financial strength sufficient to meet requirement of the ongoing OEM production ramp-up.

The motivations are somewhat more varied when considering the defense portion of the sector. Many assume that under most budget scenarios, cyber security and unmanned vehicles will remain priorities. Thus defense contractors continue to enter into new transactions for these targets that, as more emerging industries/capabilities, tend to be relatively small in size. In addition, there continue to be some deals for commercial aerospace targets, both rotary and fixed wing. However, the more subtle trend is that defense companies are buying adjacent government services businesses in order to improve capabilities in markets with a more stable and higher growth outlook. Many of these deals are also small in nature, or have undisclosed values, and have fallen in the areas such as healthcare technology and communications.

Absent a resolution to the budget issues, large defense companies will likely remain focused on small-scale M&A and organic growth through expanding foreign military

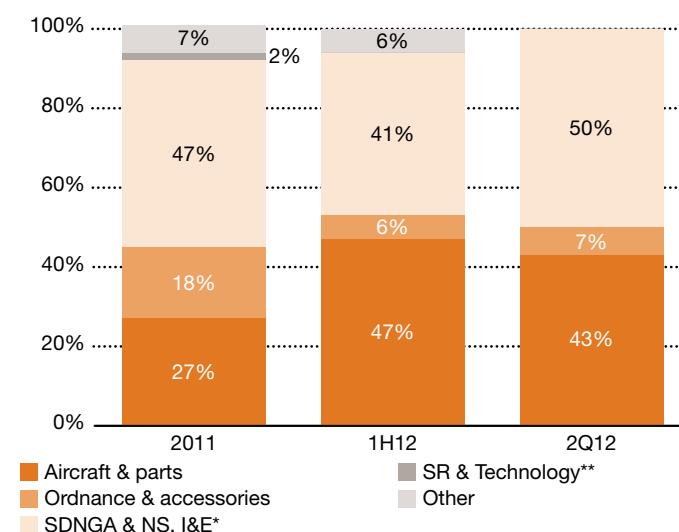
sales. However, under the most bearish defense spending scenarios, significant horizontal consolidation among the largest defense companies is possible and could lead to some historically large deals.

Overall valuations are down from 2011, reflecting the caution of acquirers in this market, with multiples for defense targets generally lagging behind the sector average. This is unlikely to reverse as growth prospects between the aerospace and defense parts of the sector should remain divergent. Stock swaps have become more popular as a method for financing deals, which at first seems counterintuitive given the aforementioned trend in valuation; however, since many of the larger deals that have been announced fall outside of the defense industry, this reflects the better “currency” that many aerospace acquirers have when using their stock to pay for new transactions. In addition, the proportion of acquirers that are publicly traded has increased this year, which creates an option to use stock swaps that did not exist to the same degree as in the past.

Another trend of interest is the rise in unsolicited bids. The trend is less significant than the trend in stock swaps; however, it is possible that the increase in cash position and relatively low valuations are making unsolicited bids a reasonable option for more acquirers.

## Deals by aerospace & defense category

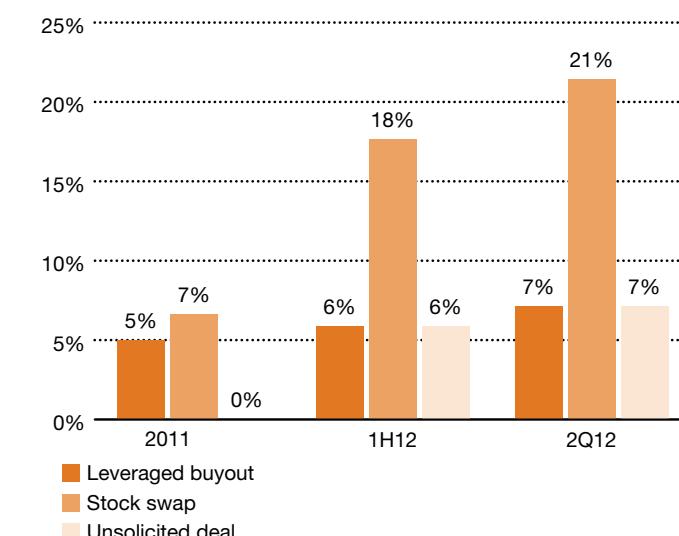
Measured by number of deals worth \$50 million or more



\* Search, Detection, Navigation, Guidance, Aeronautical, and Nautical Systems and Instruments & Equipment  
\*\* Space Research & Technology

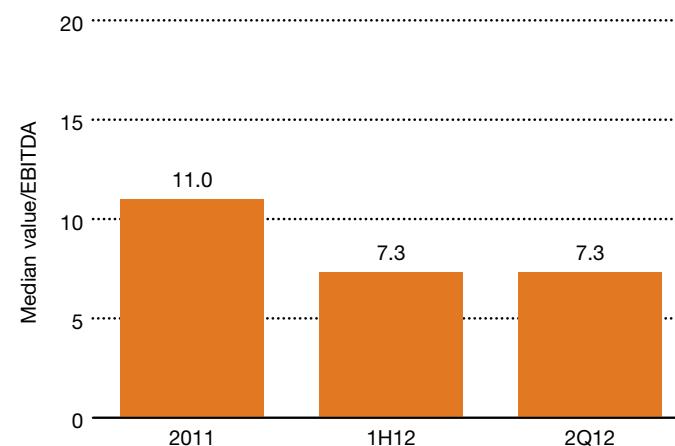
## Acquisition techniques

Measured by percentage of deals worth \$50 million or more



## Deal valuation by median value/EBITDA

Measured by value/EBITDA for deals worth \$50 million or more



## Mega deals (2011) and deals over \$500 million (1H12)

There have been no mega deals, defined as deals with a disclosed value of at least \$1 billion, announced during the first half of the year. This follows the announcement of six such deals in 2011. However, this table does not reflect the announcement in July of a \$1.8 billion offer for Hawker Beechcraft by Superior Aviation Beijing. Superior Aviation, in which the Beijing municipal government is a minority investor, owns small helicopter and related aviation businesses in the United States and China. This announcement follows other notable China-to-US general aviation announcements in recent years, including AVIC's acquisitions of Cirrus Industries and piston engine manufacturer Teledyne Continental Motors, as the country builds its domestic aerospace industry. The transaction remains subject to approvals from the bankruptcy court as well as the US and Chinese governments, and it is possible that another bidder could still emerge.

One positive harbinger of deal activity is that the two largest deals of the first half were announced this quarter. These deals, as well as the three largest deals announced in the second quarter, involved satellite targets.

The largest deal announced during the first half of 2012 is the \$0.9 billion MacDonald, Dettwiler and Associates (MDA) announcement for Space Systems/Loral (SS/L).

SS/L produces satellites for commercial and government end-markets and this transaction will help MDA gain more exposure to the US markets, particularly in commercial communications satellites.

The second-largest deal is the GeoEye \$0.8 billion offer for DigitalGlobe, which has been rejected by DigitalGlobe's board. The two companies provide commercial satellite imagery to the US government. It is possible that the two companies could still merge given the expected declines in the US federal budget, though it is uncertain which company would end up as the acquirer and which the target. Consolidation could also be encouraged by reports that the Obama administration is considering changing US imagery policy to no longer require the maximum practical reliance upon commercial providers.\*

The third-largest announcement was TransDigm's acquisition of AmSafe Partners from Greenbriar Equity Group and Berkshire Partners for \$750 million. The acquisition gives TransDigm more exposure to A380, A350, and 787 programs through safety and restraint equipment.

\* <http://defense.aol.com/2012/06/04/white-house-to-reconsider-commercial-space-imagery-policy/>

### Mega-deals in 2011 (deals with a disclosed value of at least \$1 billion)

Month announced	Target name	Target nation	Acquirer name	Acquirer nation	Status	Value of transaction in US\$ bil.	Category
Sep	Goodrich Corp	United States	United Technologies Corp	United States	Pending	16.18	Aerospace
Mar	Tognum AG	Germany	Engine Holding GmbH	Germany	Completed	4.72	Defense
Jan	ITT Defense & Information	United States	Shareholders	United States	Completed	2.10	Defense
Jan	Huntington Ingalls Industries Inc	United States	Shareholders	United States	Completed	2.01	Defense
Apr	SRA International Inc	United States	Providence Equity Partners LLC	United States	Completed	1.79	Defense
Oct	IAE International Aero Engines AG	United States	Pratt & Whitney Co	United States	Completed	1.50	Aerospace

### Deals over \$500 mil in 1H12

Month announced	Target name	Target nation	Acquirer name	Acquirer nation	Status	Value of transaction in US\$ bil.	Category
Jun	Space Systems/Loral Inc	United States	MacDonald Dettwiler & Associates Ltd	Canada	Pending	0.88	Space
May	DigitalGlobe Inc	United States	GeoEye Inc	United States	Intended	0.79	Space
Jan	AmSafe Partners Inc	United States	TransDigm Group Inc	United States	Completed	0.75	Aerospace

### Regional

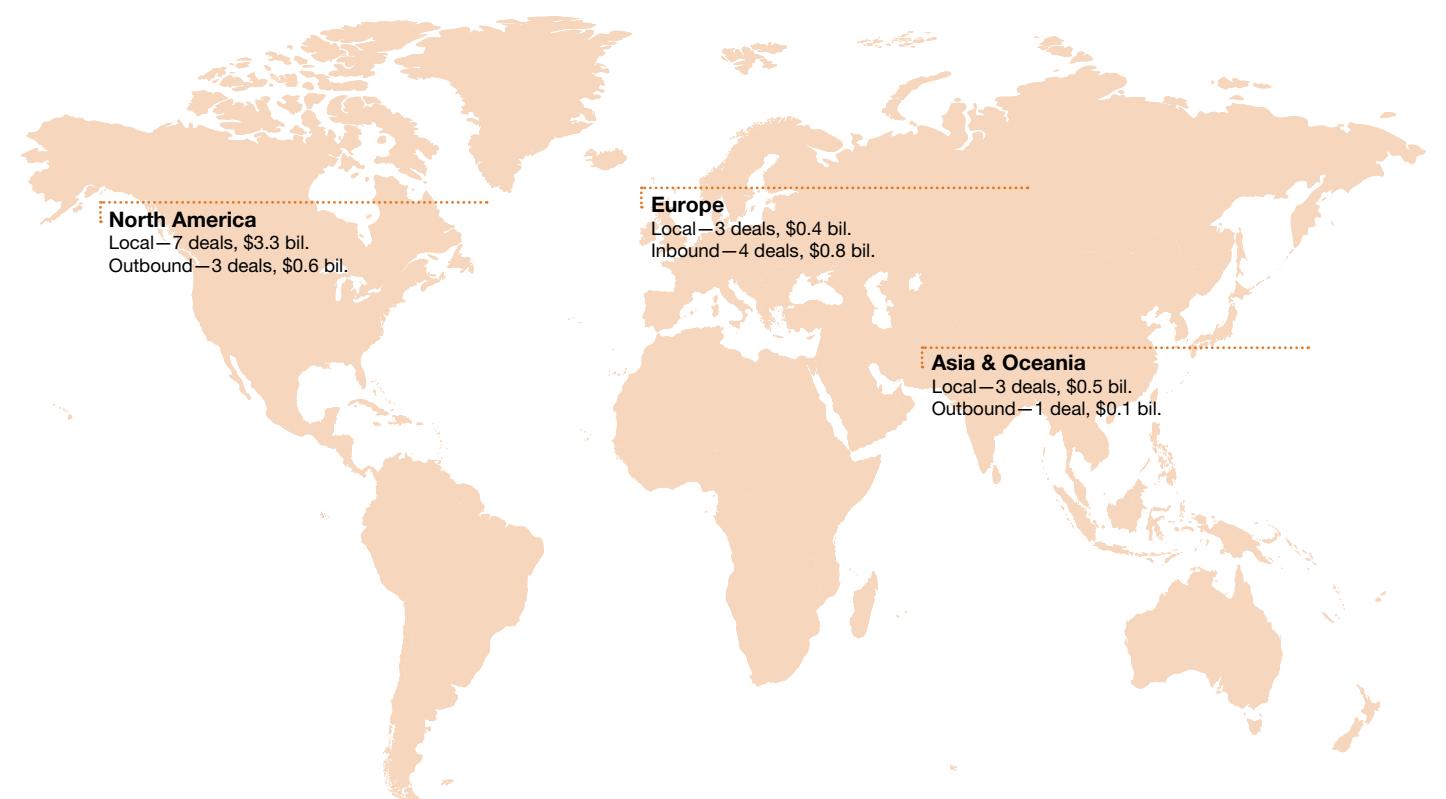
The regional distribution of deals in the aerospace and defense sector exhibits a general trend away from North America and toward Asia. This is consistent with growth in defense budgets in Asia as well as this region's ambitions to grow domestic aerospace industries.

This shift has also influenced several other regional trends, including the growth in importance of BRIC and emerging market sector constituents to the overall deal market. For example, BRIC entities accounted for roughly 15% of deals in 2011, but have been involved in almost 30% of deals in 2Q12. While cross-border deals like the Superior Aviation's bid for Hawker Beechcraft have received a lot of media attention, it is noteworthy that most of these deals are local-market transactions focused on building aerospace national champions.

In North America, local-market deals were very common, led by several of the aforementioned large satellite deals. Defense M&A activity above the \$50 million threshold was limited in this region and is likely to remain so in light of the potential sequestration.

Inbound transactions into Europe were also a driver of regional totals. It is difficult to ascribe one theme to these deals given the variety of targets involved (e.g., composites, MRO). However, the relative weakness of the Euro, which has been related to economic and fiscal issues in Southern Europe, seems likely to increase the potential that European targets will be a driver of activity in future periods. In addition, budget pressures across the continent may encourage more trans-national defense cooperation, which could lead to more M&A emanating from this region.

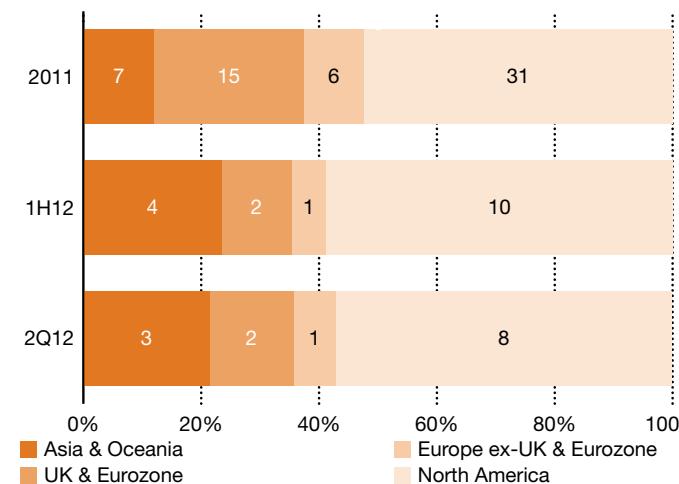
### Acquisition money flows in 1H12



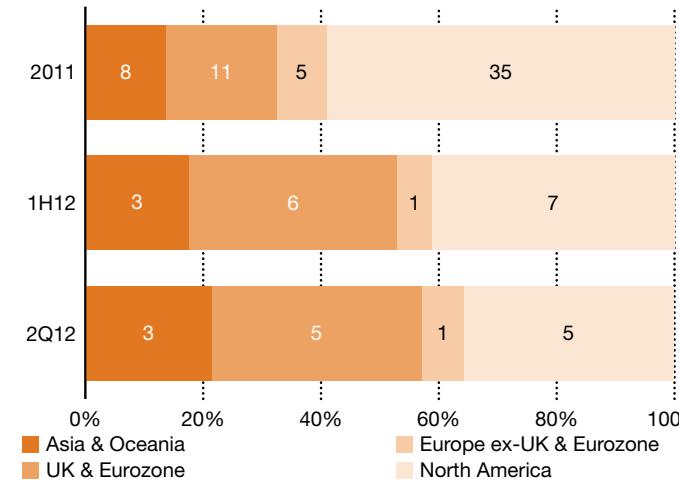
\* In July AB Volvo announced the sale of Volvo Aero to GKN for \$1.02 billion and United Technologies Corp. announced the sale of Rocketdyne to GenCorp for \$550 million, which will be included in our Third Quarter analysis.

## PwC's aerospace and defense experience

**Regional distribution of all deals by acquirer region**  
Measured by number of deals worth \$50 million or more



**Regional distribution of all deals by target region**  
Measured by number of deals worth \$50 million or more



### Deep aerospace and defense experience

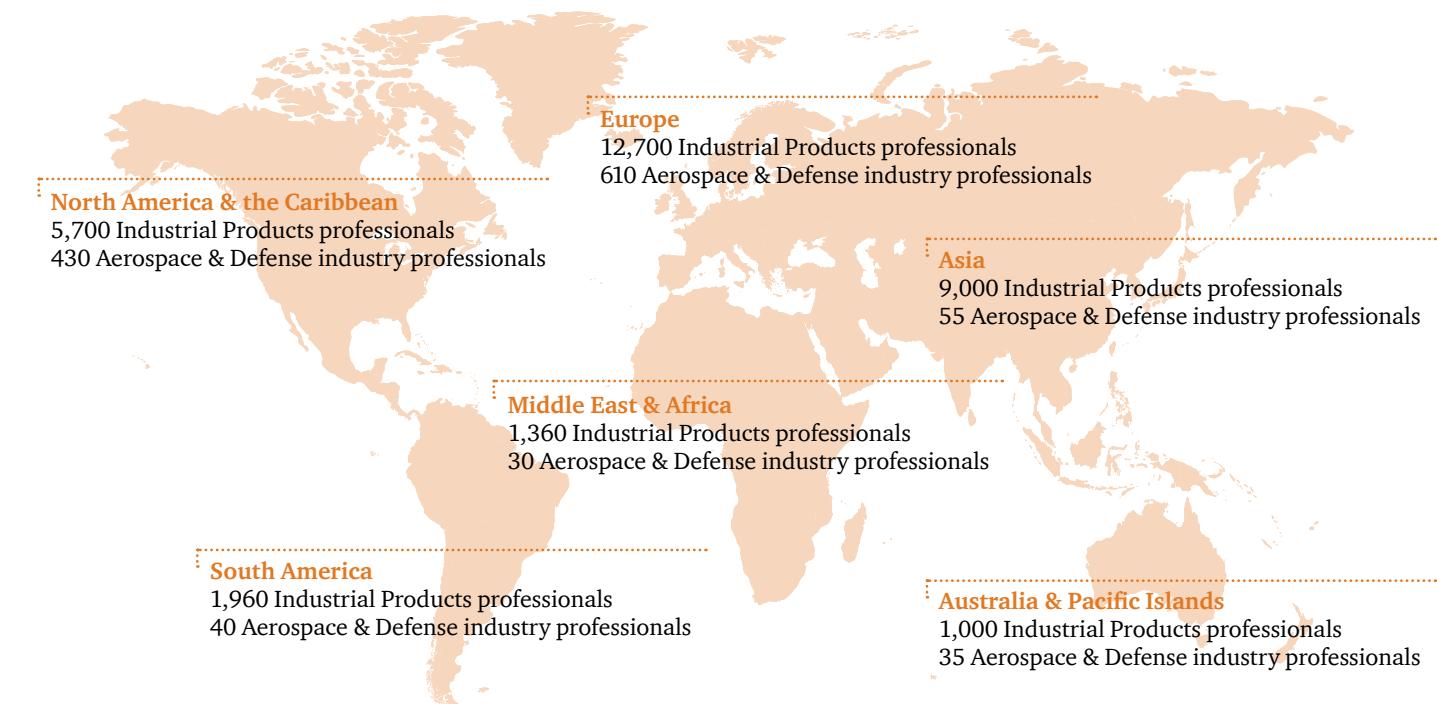
PwC's A&D practice is a global network of 1,200 partners and client service professionals who provide industry focused assurance, tax, and advisory services to leading A&D companies around the world. This A&D experience is enhanced by our Public Services practice, which includes an additional 600 partners and 9,000 professionals focused on assisting federal, state, and local governments, international agencies, and healthcare entities. We help A&D companies address the full spectrum of industry-specific challenges across areas such as assurance, tax, operational improvement, supply chain management, program management effectiveness, IT effectiveness and security, compliance, export control, and government contracting. PwC's A&D client service professionals are committed—both individually and as a team—to the relentless pursuit of excellence, building insights, and advancing leadership on a wide range of the most critical challenges and issues confronting A&D organizations. PwC is a sponsor of leading industry conferences and frequently writes articles for, or is quoted in, leading industry publications. We are proud of our relationships with Aviation Week and Flight International as well as our participation in industry conferences and associations, such as the Aerospace Industries Association and American Conference Institute. Our involvement in these organizations reflects our commitment to addressing industry needs and the furthering of dialogue with A&D industry leaders.

### Quality deal professionals

PwC's Transaction Services practice, with approximately 6,500 dedicated deal professionals worldwide, has the right industry and functional experience to advise you on all factors that could affect a transaction, including market, financial accounting, tax, human resources, operating, information technology, and supply chain considerations. Teamed with our A&D practice, our deal professionals can bring a unique perspective to your transaction, addressing it from a technical as well as industry point of view.

### Local coverage, global connection

PwC's Aerospace & Defense industry practice is a global network of nearly 1,200 professionals who serve the A&D industry and is a part of an Industrial Products group that consists of more than 31,500 professionals, including approximately 18,600 providing assurance services, 7,700 providing tax services and 5,200 providing advisory services.



\* Charts do not include one deal in South America during 2011

## Contacts

### PwC's global Aerospace and Defense practice

PwC's A&D practice provides industry-focused assurance, tax, and advisory services. Through our global network, we can draw upon the in-depth industry experience of our professionals where your company operates. Our people can help you understand the challenges of today, and the potential implications for tomorrow.

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## Methodology

*Mission control* is an analysis of mergers and acquisitions in the global aerospace and defense industry. Information was sourced from Thomson Reuters and includes deals for which targets or acquirers have primary SIC codes that fall into one of the following SIC industry groups: 1) ordnance and accessories, except vehicles and guided missiles; 2) aircraft and parts; 3) national security; 4) guided missiles, space vehicles, and parts; 5) search, detection, navigation, guidance, aeronautical and nautical systems, and instruments and equipment (SDNGN & NS, I&E); and 6) space research and technology.

This analysis includes all individual mergers and acquisitions for disclosed or undisclosed values, leveraged buyouts, privatizations, minority stake purchases, and acquisitions of remaining interest announced between July 1, 2010, and June 30, 2012, with a deal status of completed, intended, partially completed, pending, pending regulatory approval, unconditional (i.e., initial conditions set forth by the acquirer have been met but deal has not

been completed), or withdrawn. The term deals, when referenced herein, is used interchangeably with transactions and announcements. Unless otherwise noted, the term deals refers to all deals with a disclosed value of at least \$50 million.

Regional categories used in this report approximate United Nations (UN) Regional Groups as determined by the UN Statistics Division, with the exception of the North America region (includes North America and Latin and Caribbean UN groups), the Asia and Oceania region (includes Asia and Oceania UN groups), and Europe (divided into United Kingdom, plus Eurozone and Europe ex-UK and Eurozone regions). The Eurozone includes Austria, Belgium, Cyprus, Finland, France, Germany, Ireland, Italy, Luxembourg, Malta, Netherlands, Portugal, Slovenia, and Spain. Oceania includes Australia, New Zealand, Melanesia, Micronesia, and Polynesia. Overseas territories were included in the region of the parent country. China, when referenced separately, includes Hong Kong.

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