www.pwc.com/us/industrialproducts

Mission control
Third-quarter 2012 aerospace and defense industry mergers and acquisitions analysis

pwc

Scott Thompson
US Aerospace &
Defense Leader

To our aerospace and defense readers

Welcome to the 2012 third-quarter edition of *Mission control*, PwC's analysis of mergers and acquisitions in the aerospace and defense industry. In this report, you'll find an overview of M&A in the sector during the third quarter, as well as 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:

- The quarter's big news was the near merger between EADS and BAE Systems, which would have created a $100 billion revenue company. Despite the deal's failure, the attempt may suggest a new wave of consolidation.
- SAIC announced a spin off, a continuation of a multiyear divestiture trend.
- M&A activity remained restrained during the quarter, with overall deal volume declining. Deal value, however, increased, driven by the year's first mega-deal, the $1.8 billion Superior Aviation announcement for Hawker Beechcraft. While the Superior/ Hawker Beechcraft talks eventually ended without agreement, the bid comes on the heels of other notable announcements from China about US civil aviation targets. Most of the other Chinese deals were smaller in value and focused on consolidating the domestic sector.
- Deal activity in the United States increased, with acquirers focused on a variety of targets. The region is expected to remain attractive to acquirers due to the large number of potential aerospace targets in the market, as well as the relative size of defense-related demand.
- Aerospace continues to be the major theme of sector M&A, with defense transactions restrained by uncertainty about the "fiscal cliff" and the future of defense spending.
- As sector constituents wait for clarity regarding future budgets, consolidation among large defense contractors has not, for the most part, been a factor. Once the full impact of sequestration becomes apparent, though, defense companies can act on acquisition strategies under more certain conditions.

Going forward, the A&D deal environment is expected to remain suppressed and oriented toward aerospace and smaller transactions. Sequestration could be delayed by as much as six months to allow the new Congress to negotiate a deal, a scenario that could extend the suppressed M&A market into the middle of 2013.

We remain optimistic about the period following the resolution of the budget debate, and we anticipate that larger defense deals will resume their role in driving a robust market for M&A in the sector.

We're pleased to present this edition of *Mission control*, which we hope will provide you with a deeper understanding of M&A trends and prospects in the industry.

Sincerely,

Perspective

The big news of the quarter is the "deal that wasn't," as EADS and BAE Systems announced that they were negotiating a blockbuster merger that would have created a $100 billion revenue company; the deal later fell apart because of concerns by government stakeholders. Despite the fact that the deal has been abandoned, we feel that it might signal the beginning of further attempts at consolidation. The failed deal also raises other questions, such as what is next for these two companies, and whether consolidation in European defense will be hindered by government stakeholders.

In other news during the quarter, SAIC announced its separation into a technical services business focused on government and enterprise IT, as well as a solutions business focused on security, engineering, and health. This is a continuation of the divestiture trend that we have seen over the past several years and is intended to help SAIC mitigate issues related to organizational conflict of interest (OCI) rules. This deal will be included in our M&A totals once the spinoff occurs.

Mergers and acquisition activity was fairly restrained, with acquirers generally displaying caution. However, although overall deal volume was down in the quarter, deal value increased, compared with the previous three quarters, because of the first mega-deal of this year, the $1.8 billion Superior Aviation announcement for Hawker Beechcraft (subsequently withdrawn).

The Superior/Hawker Beechcraft deal followed other announcements by China for US civil aviation targets in recent years, and while there are legal and regulatory hurdles to closing this deal, we expect continued interest by China to build out their aerospace capabilities, to the extent allowed by foreign nations. Despite the high-profile nature of this particular deal, it is noteworthy that much of the remainder of China's A&D deal activity was smaller in value and focused on consolidating the domestic sector. These deals seem likely to contribute to the bulk of near-term transactions in Asia.

The United States was more active this quarter, with acquirers focusing on a variety of targets. We expect the United States to remain attractive to acquirers because of the large number of potential aerospace targets in this market, as well as the relative size of defense-related demand. Aerospace continues to be more active in the sector's M&A, with defense transactions suppressed because of the uncertainty over both the fiscal cliff and the future of defense spending. And in fact, despite the decline in overall deal flow from a record-setting 2011, aerospace M&A volume is actually on pace to exceed the levels of the previous year. Both strategic and financial investors have shown more interest in this segment of the market.

Consolidation among large defense contractors has generally been off the table as sector constituents wait for more clarity on future budgets. Once these budget uncertainties are resolved, however, defense companies that have held off on large deals may move forward with acquisition strategies under more certain conditions and, in doing so, pave the way for a strong 2013. Budgets cuts could also shape industrial policies and the extent to which consolidation is permitted.

All factors considered, the most likely scenario for fourth-quarter 2012 is an A&D deal environment that remains suppressed and skewed heavily toward aerospace and smaller deals. Furthermore, one scenario emerging from Washington is that sequestration could be delayed by perhaps six months to allow the new Congress to negotiate a deal. If that happens, we may see a suppressed M&A market into the middle of 2013, which is generally in line with how we have assessed the third quarter. However, we do remain optimistic that, following the resolution of the budget debate, larger defense deals may resume their role in driving a strong market for M&A in this sector.

Deal totals

Deal activity in the third quarter was light, compared with recent history, although there was a rise in average values within the sector in comparison with the previous three quarters. This deal value was driven by the first mega-deal — that is, a deal with a disclosed value of at least $1 billion — of the year, the attempted $1.8 billion Superior Aviation acquisition of Hawker Beechcraft.

And the focus of deal activity this quarter was the United States. Although the volume of 3Q12 deals was limited, US entities accounted for the majority of acquirers and targets. Average deal sizes for non-US deals were up significantly, driven by the GKN/Volvo Aero deal, the second-largest transaction of the quarter.

The quarter was somewhat lackluster in terms of overall activity, and much attention was focused on the mega-merger talks between EADS and BAE Systems. Although the talks were abandoned on October 10, the potential merger has nevertheless reignited discussions on the future of a number of large A&D companies and whether a further round of large-scale and international consolidation is a necessary step for the industry.

In previous reports, we have shared our expectation that sequestration in the United States could keep many potential defense deals on the sidelines. We expect that this will continue to affect totals into the fourth quarter, as uncertainty over growth outlooks and valuations of potential targets remain impediments to deal flow. However, the resolution of the sequestration issue should provide a catalyst for a strong 2013. Because the degree and targets of these potential cuts have remained uncertain, it has been difficult for defense companies to value companies. Once the specifics of any additional defense budget cuts related to sequestration are made clear, it should motivate top defense contractors to consider larger, more transformative M&A opportunities. The sequestration issue is not likely to be resolved until after the US elections in November.

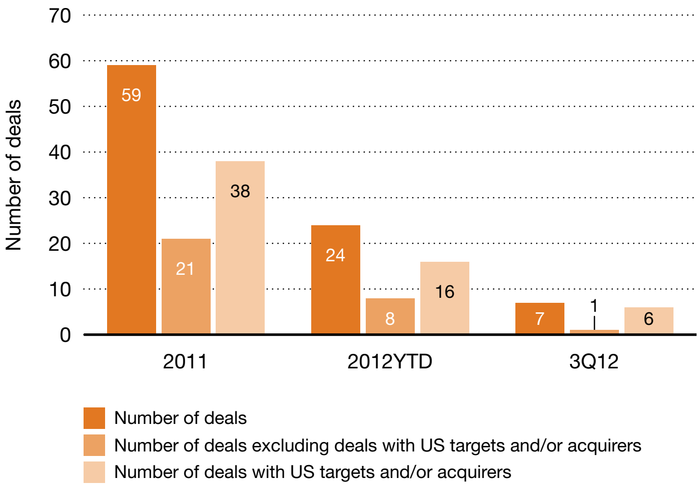
Accordingly, our outlook for deal activity in the medium- and long term is relatively bright, although aerospace and defense M&A will likely focus on small- to middle-market deals in the near term. Divestitures of non-core defense businesses and a healthy interest in aerospace M&A should remain hallmarks of the deal market for the balance of the year.

Quarterly A&D deal activity
Measured by number and value of deals worth $50 million or more

	2009	2010				2011				2012		
	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q
Number of deals	12	10	13	17	26	22	15	11	11	3	14	7
Total deal value ($ bil.)	5.1	5.7	6.3	5.1	6.4	12.6	6.2	20.3	3.5	1.3	3.7	4.5
Average deal value ($ bil.)	0.4	0.6	0.5	0.3	0.2	0.6	0.4	1.8	0.3	0.4	0.3	0.6

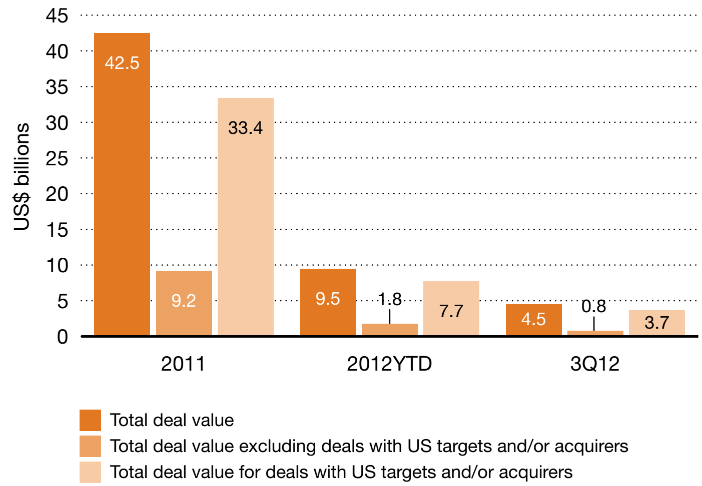
Deal activity by number of deals

Measured by number of deals worth $50 million or more



Deal activity by total deal value

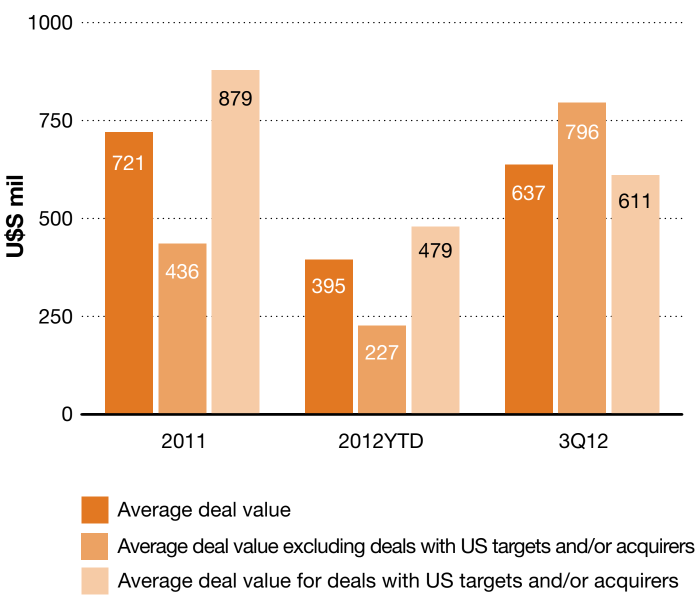
Measured by value of deals worth $50 million or more



Note: Numbers in this graphic have been rounded

Deal activity by average deal value

Measured by value of deals worth $50 million or more



Deal categories and acquirer types

The trend toward an increase in deals focused on aerospace targets continued through the third quarter, with interest up significantly from 2011. While the proportion of financial investor-led deal volume has remained relatively consistent over the past several years, the focus of these deals has also shifted toward aerospace. Looking forward, strategic investors seem more likely to drive aerospace deals due to generally higher synergy benefits from creating a more robust supply chain through consolidation. Financial investors seem more likely to focus on defense assets once the budget uncertainty is resolved, although the proportion of financial investor-led deals within A&D has recently been shifting somewhat toward aerospace.

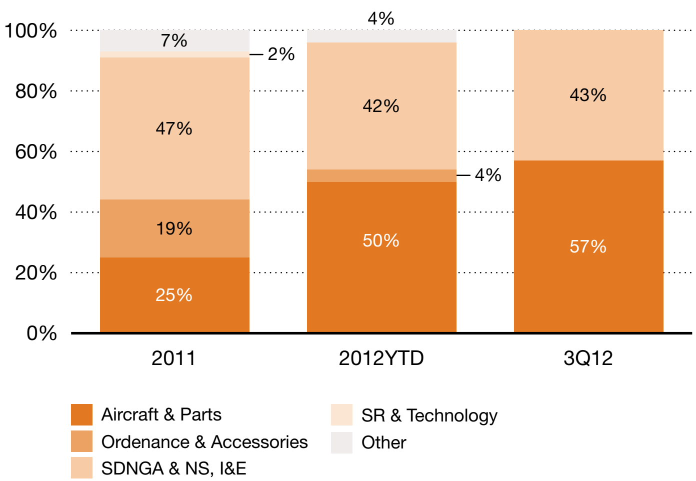
Deal valuation, as measured by median value to sales ratios, has moved downward. It is interesting that, despite the high level of interest in aerospace, multiples for these targets have also trended downward. This seems attributable to a relatively small sample of deals this quarter, as well as to the fact that several of these aerospace deals were for distressed targets. Over the longer term, interest in a range of assets should broaden the focus of aerospace deals. Accordingly, aerospace multiples seem more likely to expand than contract in future quarters due to expected growth, compared with much of the rest of the sector.

The market has recently been driven by defense companies selling off their industrial units, as we have highlighted in previous reports, but divestitures may accelerate once budget details in the United States are determined. The focus of these deals seems likely to shift toward non-core defense assets, providing additional opportunities for private equity investment in the sector.

The acquisition of ancillary government services and technology businesses by defense companies continued into the third quarter; SAIC, for example, announced the $493 million acquisition of maxIT Healthcare, a healthcare technology firm. But despite the focus on aerospace targets, and taking into account all announcements this quarter, we see that deals have largely remained focused on consolidation in the sector, with investors primarily looking at acquiring core A&D businesses, rather than companies that could be considered to fall outside of the sector.

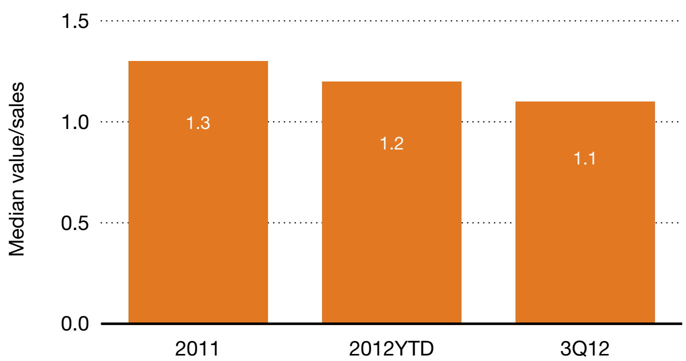
Deals by aerospace & defense category

Measured by number of deals worth $50 million or more



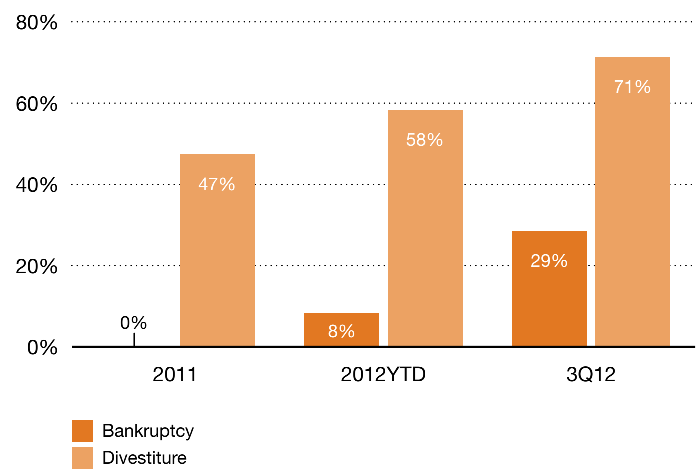
Deal valuation by median value/sales

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



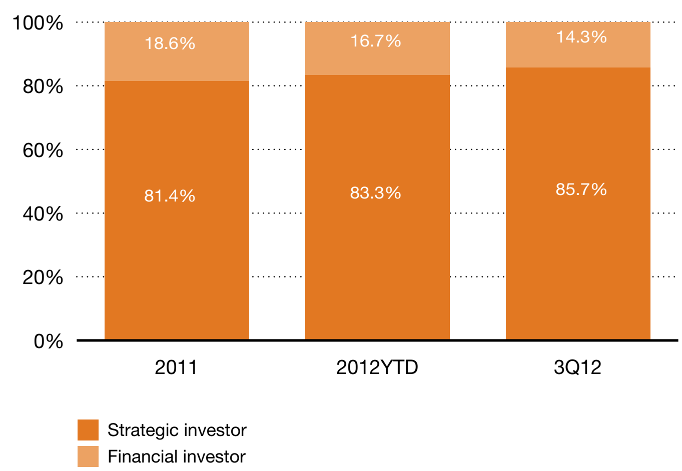
Acquisition techniques

Measured by percentage of deals worth $50 million or more



Deal activity by investor group

Measured by number of deals worth $50 million or more



Mega deals (2011) and deals over $500 million (2012YTD)

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	Completed	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 2012YTD

Month announced	Target name	Target nation	Acquirer name	Acquirer nation	Status	Value of transaction in US$ bil.	Category
Jul	Hawker Beechcraft Acquisition Co LLC	United States	Superior Aviation Beijing Co Ltd	China	Withdrawn	1.79	Aerospace
Jun	Space Systems/Loral Inc	United States	MacDonald Dettwiler & Associates Ltd	Canada	Pending	0.88	Space
Jul	Volvo Aero AB	Sweden	GKN PLC	United Kingdom	Pending	0.80	Aerospace
May	DigitalGlobe Inc	United States	GeoEye Inc	United States	Withdrawn	0.79	Space
Jan	AmSafe Partners Inc	United States	TransDigm Group Inc	United States	Completed	0.75	Aerospace
Jul	Pratt & Whitney Rocketdyne Inc	United States	GenCorp Inc	United States	Pending	0.55	Space

The first mega-deal of the year, i.e., a deal with a disclosed value of at least $1 billion, was announced in July. This compares with the robust rate of six mega-deals announced during all of 2011. In comparing the makeup of the six mega-deals of 2011 with the six largest deals so far in 2012, we see clearly the shift away from defense deals. Many potential defense-related mega-deals are off the table, and this has taken a significant amount of potential deal flow from the top of the market.

The only mega-deal so far in 2012 is Superior Aviation's $1.8 billion announcement for Hawker Beechcraft's civil aviation business. The parties to this announcement were in exclusive negotiations and faced several potential hurdles. If the deal had closed, Hawker Beechcraft's defense assets would likely be separated and owned by primary creditors, although they could be sold later. However the talks ended in mid-October without an agreement. This bid was the most high profile of China's general aviation deals in the United States, and it follows the announcements by AVIC and related entities for Cirrus (2011), Teledyne Continental Motors (2010), and Epic Air (2010, although it was subsequently acquired by Russia's Engineering LLC). More aviation bids could be expected as China attempts to expand its civil (and, indirectly, its military) technology as well as increase foreign sales.

The second-largest deal of the quarter was the $0.8 billion announcement by British engineering firm GKN for Volvo AB's aerospace business, Volvo Aero, which manufactures engine sub-assemblies and components. Volvo sought a divestment after deciding to focus on heavy commercial vehicles. This acquisition will also increase GKN's exposure to the aerospace end market, notably in engines to complement its aero structures business.

The third-largest deal of the quarter was the $550 million sale of Rocketdyne by United Technologies to GenCorp. Rocketdyne is the world's largest manufacturer of liquid-fueled rocket propulsion systems. United Technologies has used divestitures, including those of both Rocketdyne and an industrial pumps and compressors business, to fund their recent $16.8 billion acquisition of Goodrich.

Regional deal activity

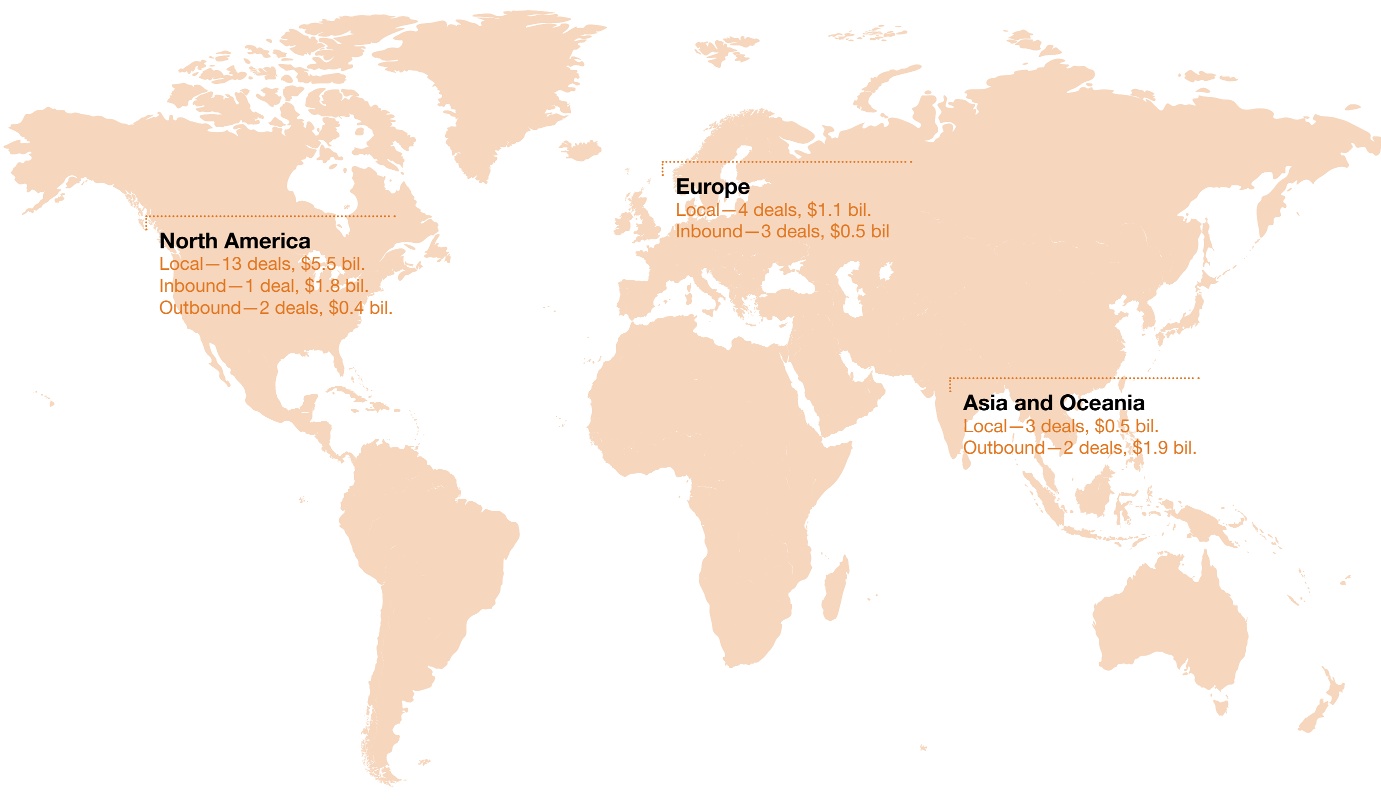
Local deals continue to account for the majority of all announcements, although there has been a slight shift toward more cross-border deals during the third quarter. On a regional basis, North America and the United States are becoming even more prominent in terms of sector deal volumes. While US deals announced earlier this year were led by transactions for satellite targets, the motivations behind more recent US announcements are varied. They included the attempted sale of distressed assets (e.g., Superior/Hawker Beechcraft), the sale of non-core industrial businesses by defense contractors (e.g., GenCorp/United Technologies-Rocketdyne), and diversification by defense contractors into higher-growth businesses (SAIC/maxIT).

Several of these drivers should persist into the fourth quarter; however, as the nature of sequestration-related budget cuts becomes clearer, large strategic defense deals will likely accelerate in response to a new demand environment. This potential trend could be supported by any US decision to revisit defense industrial policy in light of the eventual budget.

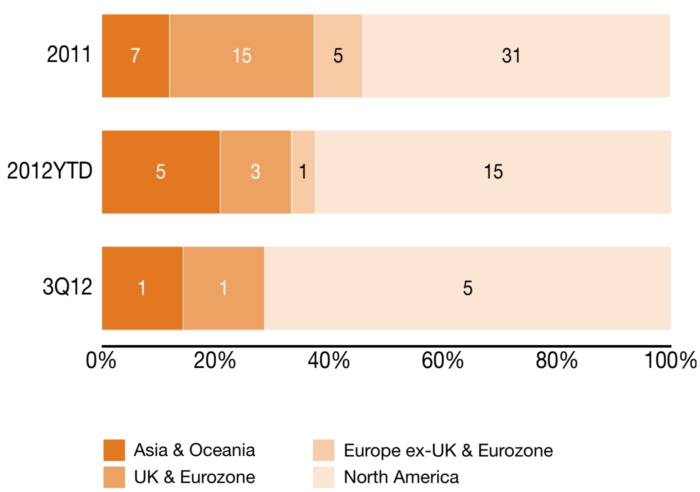
Despite the inclusion of Superior's eventually unsuccessful bid for Hawker Beechcraft as the largest deal of this quarter, China's role in the deal market declined somewhat during this quarter for deals over $50 million. This is in contrast to the more prominent role of China and other BRICs in deal-making of this size earlier this year. However, when taking into account all deals, regardless of whether a value was disclosed, the proportion of BRIC deals remains strong. Many of these are small/undisclosed local market transactions in China and Russia, which have likely kept them off the global radar. Deals involving BRICs, and China in particular, are likely to increase, due to aspirations of building domestic aerospace industries and growth in domestic military spending. Such an increase would likely motivate more outbound deals to build capabilities, as well as contribute to additional local deals in order to consolidate and strengthen existing competitors in the market.

Finally, overall European activity — local, inbound, and outbound — was not particularly strong this quarter, with many European deals in the small and undisclosed segments. When all announcements are considered, European parties accounted for over one-third of deal volume in the third quarter. At the $50 million-plus level, European inbound deals increased, with these announcements motivated by a variety of strategic needs. It is possible that the continued weakness in the Eurozone could make these assets incrementally more attractive to foreign acquirers. The long-term driver of M&A for this region is likely to be consolidation within Europe, as weaker defense budgets motivate cross-border defense cooperation.

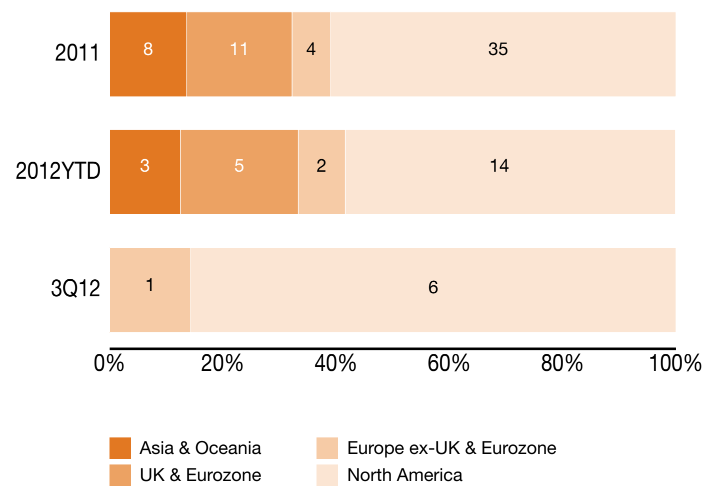
Global aerospace and defense deals in 2012YTD
Measured by number and value of deals worth $50 million or more



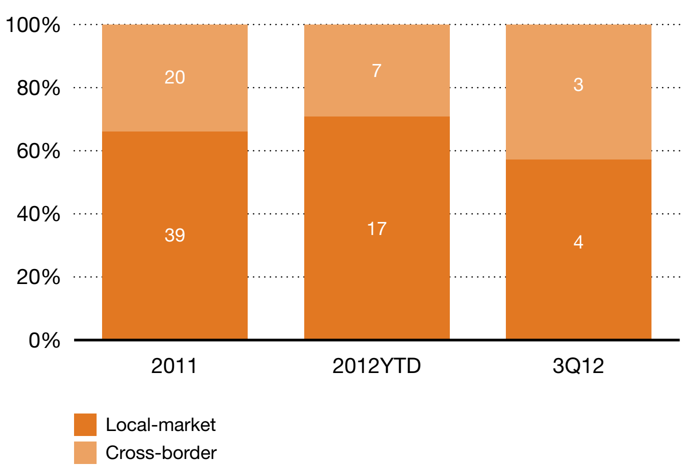
Regional distribution of all deals by acquirer region*
Measured by number of deals worth $50 million or more



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



Local-market versus cross-border deals, all nations
Measured by number of deals worth $50 million or more



* Chart does not include one deal in South America for 2011

PwC's aerospace and defense experience

Deep aerospace and defense experience

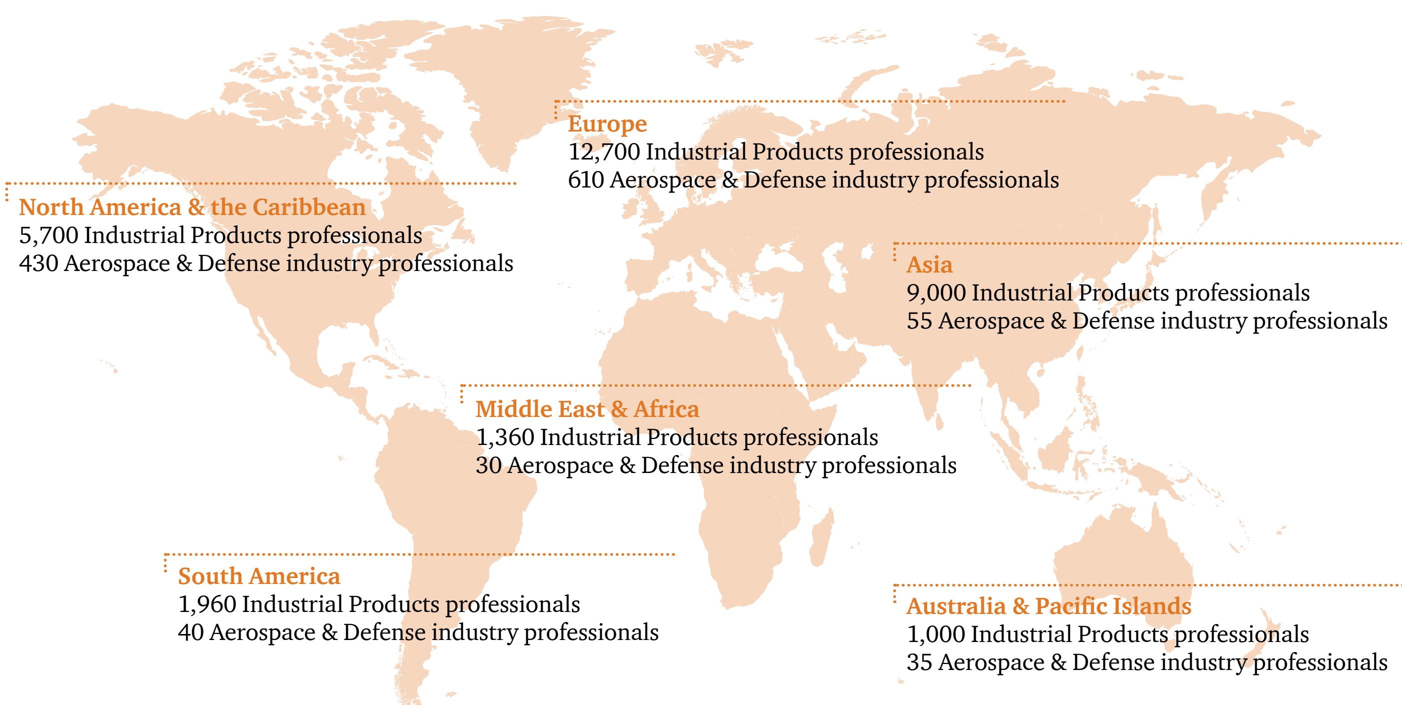
PwC's A&D practice is a global network of 1,200 partners and client service professionals who provide industry-focused assurance, tax, and advisory services to leading A&D companies around the world. This A&D experience is enhanced by our Public Services practice, which includes an additional 600 partners 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 such areas 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 Deals 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 an 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.



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.

PwC US

US Aerospace and Defense Leader
Scott Thompson—+1.703.918.1976
scott.thompson@us.pwc.com

US Aerospace and Defense Deals Leader
Bob Long—+1.703.918.3025
bob.long@us.pwc.com

US Aerospace and Defense Deals Partner
Joe Michalczyk—+1.703.918.1480
joe.michalczyk@us.pwc.com

US Aerospace and Defense Deals Director
Dale McDowell—+1.703.918.4475
dale.a.mcdowell@us.pwc.com

US Aerospace and Defense Deals Director
Michelle Ritchie—+1.703.918.3270
michelle.ritchie@us.pwc.com

US Aerospace and Defense Advisory Leader
Charles Marx—+1.602.364.8161
charles.a.marx@us.pwc.com

US Aerospace and Defense Tax Leader
James Grow—+1.703.918.3458
james.b.grow@us.pwc.com

US Aerospace and Defense Corporate Finance Director
Robert Ashcroft—+1.312.298.2364
r.ashcroft@us.pwc.com

US Industrial Products Marketing Director
Thomas Waller—+1.973.236.4530
thomas.a.waller@us.pwc.com

US Aerospace and Defense Marketing Manager
Gina Reynolds—+1.973.236.4648
gina.reynolds@us.pwc.com

US Aerospace and Defense Research Analyst
Michael Portnoy—+1.813.348.7805
michael.j.portnoy@us.pwc.com

PwC Global

Global Aerospace and Defense Leader
Neil Hampson—+44.20.7804.9405
neil.r.hampson@uk.pwc.com

Brazil Aerospace and Defense Leader
Augusto Assuncao—+55.19.3794.5408
augusto.assuncao@br.pwc.com

Canada Aerospace and Defense Leader
Mario Longpre—+1.514.205.5065
mario.longpre@ca.pwc.com

China Aerospace and Defense Leader
Huw Andrews—+86.21.2323.8800
huw.andrews@cn.pwc.com

France Aerospace and Defense Leader
Guillaume Rochard—+33.1.56.57.8208
guillaume.rochard@fr.pwc.com

Germany Aerospace and Defense Leader
Martin Theben—+49.201.438.1524
martin.theben@de.pwc.com

India Aerospace and Defense Leader
Dhiraj Mathur—+91.11.4115.0309
dhiraj.mathur@in.pwc.com

Italy Aerospace and Defense Leader
Corrado Testori—+39.06.5702.52442
corrado.testori@it.pwc.com

Middle East Aerospace and Defense Leader
Bill Lay—+ 971.4.304.3651
bill.lay@uk.pwc.com

Netherlands Aerospace and Defense Leader
Alexander Staal—+31.(0).887927242
alexander.staal@nl.pwc.com

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 October 1, 2009 and September 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, Greece, 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.

Visit our aerospace and defense industry website at www.pwc.com/us/industrialproducts

© 2012 PricewaterhouseCoopers LLP. All rights reserved. "PricewaterhouseCoopers" and "PwC" refer to PricewaterhouseCoopers LLP, a Delaware limited liability partnership, or, as the context requires, the PricewaterhouseCoopers global network or other member firms of the network, each of which is a separate legal entity. This document is for general information purposes only, and should not be used as a substitute for consultation with professional advisors. MW-13-0094 jat