

Aerospace & Defence Deals*

2008 Annual Review

Merger and acquisition activity in the global aerospace and defence industry



Contents



Introduction	01
Report highlights	02
Deal totals	04
Deal makers	06
Deal places	09
North America	11
Europe	13
Rest of the world	14
Looking ahead	16
Contact us	17

Methodology

Aerospace & Defence Deals 2008 is based on published transactions from the Dealogic 'M&A Global' database, January 2009. Analysis encompasses only those deals which were completed in the calendar year. Deal values are the consideration value announced or reported, including any assumption of debt and liabilities. Figures relate to actual stake purchased and are not multiplied up to 100%. The geographical split of the deals refers to the location of the target company. The analysis relates to the aerospace and defence development, manufacturing and services sectors, and therefore excludes commercial airlines. The analysis includes targets in commercial and military aerospace, defence, homeland security and space. Data for earlier years may differ slightly to that appearing in previous editions of our annual analysis as a result of fresh information, refinements in methodology and consequent restatement of the input database. A full list of transactions throughout 2008 is available by visiting the Aerospace & Defence Deals website at www.pwc.com/aerospaceanddefence/deals.



After flying high in previous years, aerospace and defence (A&D) deal-making descended fast in 2008. Indeed, the last three months of the year saw activity virtually dry up as concerns about the financial and economic background worsened, civil aviation overcapacity

fears hardened and the outlook for defence sector spending remained uncertain.

Aerospace & Defence Deals 2008 reviews deal activity in the A&D industry. The report is the latest edition in our annual series on deal-making in the sector, previously titled Flying High. The report is one of a range of deals publications from PricewaterhouseCoopers, covering sectors including mining, metals, renewable energy, power, oil & gas as well as A&D. Together the family of deals reports provide a comprehensive analysis of M&A activity across industries worldwide.

We examine both the rationale behind the overall trends and look at the key individual deals. We look at the year under review, the context of the preceding years, and ahead to the future direction of deal-making in the sector. We also highlight, in our deal dialogue panels, some of the critical issues for companies engaging in

deal activity within the sector. Drawing on our global experience as an adviser to aerospace & defence industry M&A players, our commentary addresses all key markets in the sector.

Looking ahead, we examine the effect of a more uncertain economic outlook on deal-making in the sector. We look at the imperatives that will continue to underpin activity as well as the factors that will inhibit deal-making. Our conclusion is that A&D deal activity will remain subdued and that companies are most likely to adopt a 'wait and see' attitude until key concerns about growth and financing have been addressed.

A handwritten signature in black ink, appearing to read 'Neil Hampson', with a stylized flourish at the end.

Neil Hampson

02 Report highlights

Deals plummet in last quarter tailspin

Total 2008 deal value in the sector more than halved, down to US\$14.3bn from US\$32.9bn the year before, and virtually dried up in the last quarter following the Autumn 2008 intensification of the credit crisis and the wider economic downturn. In the last three months of 2008, deal value shrunk to just US\$218 million. This contrasts with the final three months of 2007 when A&D disclosed deal value totalled US\$1.3bn. By the end of 2008, it was only very small deals that were taking place – average disclosed deal value in the last quarter was just US\$22 million, way short of the decade's lowest average deal level of US\$100 million, seen in 2003.

European buyers dominate transatlantic deal traffic

North America and Europe accounted for 89% of total deal value (US\$12.7bn of the US\$14.3bn total) and 79% of deal volume (132 of 167 A&D deals worldwide). Transatlantic deals dominated the deal totals, accounting for US\$9.7bn of deal value with US\$7.3bn attributable to European bids for North American targets. Indeed, the value of 2008 European outbound activity for North American targets was a record high for the whole of the decade. These strategic moves by European companies had the added bonus of being conducted at a time of relative dollar weakness.



Private equity investment falls off a precipice

The number of Private Equity (PE) deals more than halved, from 77 in 2007 to just 31 in 2008. The total value of PE deals fell off a precipice – plummeting to just US\$2.4bn from US\$16bn in 2007. US\$2.2bn of 2008 PE deal value was accounted for by just one deal – Permira's sale of Jet Aviation. In the space of 12 months, PE deals have gone from providing 49% of total A&D value to just 17% (or 1.4% excluding the Jet Aviation sale). The Jet Aviation deal provided the only US\$1bn plus deal in 2008, compared to seven such deals involving PE players the previous year.

Deal revival horizon remains distant

Deal-making is likely to be very subdued during 2009 with the drying-up of deals in the last quarter of 2008 setting the tone for 2009. As well as the market environment concerns outlined above, lack of leverage will be a key factor constraining PE buyers. Corporate buyers will be wary until they have greater certainty that values have bottomed out. Conservation of cash reserves will be a priority for many companies. More cash will be needed for vendor financing to support commercial aircraft sales and maintain deliveries. Both Boeing and Airbus, for example, have announced they intend to step up such financing. Unlike some other industries, forced selling is unlikely to be a widespread feature of deal-making although the incidence of smaller companies forced into deals is likely to increase.

Deal totals 04

A&D deal-making stalled in 2008 as companies and investors faced new market realities following the relative highs reached in 2006 and 2007. Total deal value in the sector more than halved, down to US\$14.3bn from US\$32.9bn the year before, and virtually dried up in the last quarter of 2008. The intensification of the economic downturn and financial crisis during 2008, allied with uncertainty on the outlook for defence spending in some countries, led to sentiment turning negative across much of the industry.

Taking the year as a whole, deal numbers did not take quite such a dramatic downward turn, shrinking by 23% compared with 2007. As a result, average deal value was down 27% with 2008's US\$208 million average deal value, still significantly higher than the US\$146 million level of 2005 (see Figure 1). However, much of this was driven by the deal momentum of 2006 and 2007 continuing into the first quarter of 2008. The first three months accounted for 69 of the 167 deal announcements in 2008 (see Figure 2).

After the first quarter, deal numbers more than halved. Deal value in the second and third quarters was buoyed by the timing of three US\$1bn plus deals during that period but, by the fourth quarter, deal value had shrunk to just US\$218 million. This contrasts with the final three months of 2007 when A&D disclosed deal value totalled US\$1.3bn. By the end of 2008, it was only very small deals that were taking place – average disclosed deal value in the last quarter was just US\$22 million, way short of the decade's previous US\$100 million minimum average deal level seen in 2003.

On the civil aviation front, growing numbers of airlines are seeking to defer or cancel aircraft deliveries as they cut capacity to try to match falling demand for air travel and air cargo. This has resulted in both Boeing and Airbus considering modest production cuts for either 2009 or 2010. The hoped-for major growth platform of increasing Middle Eastern and Asian demand is increasingly being

thrown into doubt. In early 2009, for example, Singapore Airlines, the world's biggest carrier by market value, announced it would cut capacity by 11% in the year from April 2009, decommissioning 17 of its 102 passenger aircraft. Reduced demand for new aircraft has started to have a knock-on effect on SME sub-contractors, many of whom have moved to cut capacity and costs.

On the defence front, 2008 deal-making faced the uncertainty of the exact implications of a new administration in the US and, in Europe, long-awaited French defence review proposals which were announced half way through 2008. The French white paper signalled a shift in defence priorities with a refocusing to 'knowledge-based security.' French spending on space-based observation, eavesdropping and ballistic missile early-warning assets will double while armed forces will be reduced by almost a fifth. Likewise, a further strategic defence review is expected in the UK.

The early days of the Obama presidency have begun to lift uncertainty. While the future of some major weapons platforms remains under review, the new president has dismissed calls to reduce the main defence budget. Indeed, President Obama has requested a 4% boost in 2010 to the Pentagon budget from Congress but it is not expected to be augmented by significant supplemental budgets as in prior years. The new president has made clear that he wants to end overspending and schedule delays in the US weapons programme. Ongoing military commitments in Afghanistan will continue to support demand for spares, overhauls and retrofits while withdrawal from Iraq will ease operational pressures on the defence budget. The expectation is that there is going to be a phased decline in US defence spending under the new administration. On balance, the outlook for the security and defence sectors remains sound although there is likely to be a refocusing of priorities across different programmes.

Figure 01: Total A&D deals, 2000-2008

	2000	2001	2002	2003	2004	2005	2006	2007	2008
Total number of deals	357	323	323	279	272	339	203	214	167
Total disclosed value of deals (US\$bn)	46.0	25.8	19.9	17.2	24.0	24.4	29.2	32.9	14.3
Average deal size (US\$bn)	0.236	0.151	0.121	0.100	0.159	0.146	0.280	0.286	0.208

Source: PricewaterhouseCoopers Aerospace & Defence Deals 2008 Annual Review

Figure 02: Quarterly flow of A&D deals, 2007 & 2008

	2007				2008			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Deal volume	51	60	51	52	69	33	32	33
Deal value (US\$bn)	12.1	14.0	5.6	1.3	3.3	7.56	3.3	0.218

Source: PricewaterhouseCoopers Aerospace & Defence Deals 2008 Annual Review

Deal makers 06

Large US\$1bn plus deals were thin on the ground in 2008. Only three such deals featured in the top ten A&D deals table, the lowest number in the entire decade beginning 2000. In most previous years there were typically at least half a dozen deals that topped the US\$1bn mark. Nonetheless, the biggest deal of 2008 – Finmeccanica’s US\$5.6bn purchase of DRS Technologies – ranks as one of the most noteworthy of the decade both in terms of size and industry significance.

Indeed, Finmeccanica’s move is the third largest of the decade. It adds a ‘third pillar’ to the Italian company’s expansion in the US, adding DRS’s range of defence technology to the presidential helicopter contract won by its AgustaWestland subsidiary and its work on the carbon composite shell of Boeing’s 787 Dreamliner. In a context where nationalism plays a part in deal-making, both in terms of jobs and defence interests, Finmeccanica is keeping DRS’s management and headquarters and running the newly acquired company as a wholly owned subsidiary.

Finmeccanica’s growth as an A&D player during the decade is significant. Back in 2000, it was an industrial conglomerate and was part-privatised by the Italian government. The US\$4.8bn sale released 39.3% of the company to the market in what was the biggest A&D deal of the year. The government retains just under 34% of Finmeccanica. Since 2000, the company has disposed of non-core assets and built a strong, focused aerospace and defence platform in both Europe and the US that has catapulted it into a strong international position vis a vis European and US competitors.

The second largest A&D deal of 2008 topped what was a shrinking list of deals involving PE players (Figure 5). The US\$2.2bn sale of Swiss-based Jet Aviation to US group General Dynamics gave Permira, a UK-based private equity firm, an exit and a substantial return on its investment after acquiring the business aviation service company in 2005. General Dynamics is one of the world’s leading business jet manufacturers, owning Gulfstream. The deal extends the company’s portfolio of business aviation services, particularly into the Middle East and Asia, putting it in a stronger position to benefit from long-term growth outside of North America.

The dearth of leverage available to private equity players has significantly curtailed their buy-side involvement in the A&D deal market. Large scale buy-outs of the likes of Onex and Goldman Sachs’ 2006 US\$3.2bn purchase of Raytheon Aircraft to form Hawker Beechcraft, or Carlyle Group’s 2007 US\$2.6bn Sequa acquisition, are much less likely in current conditions. The Jet Aviation sale was the only large transaction in a rapidly shrinking PE deal list where PE sell-side motivations replaced the buy-side activity of recent years. The number of PE deals more than halved, from 77 in 2007 to just 31 in 2008. The total value of PE deals fell off a precipice – plummeting to just US\$2.4bn (or just US\$0.2bn excluding the Jet Aviation sale) from US\$16bn in 2007. In the space of 12 months, PE deals have gone from providing 49% of total A&D value to just 17% (or 1.4% excluding the Jet Aviation sale). The Jet Aviation deal provided the only US\$1bn plus deal in 2008, compared to seven such deals involving PE players the previous year.

Figure 03: Top ten – A&D deals 2008

Rank	Target	Target Description	Bidder	Target Nation	Bidder Nation	Value (\$bn)
1	DRS Technologies Inc	Supplier of defence electronics products and systems	Finmeccanica SpA	United States	Italy	5.602
2	Jet Aviation management	Aviation service company, provides maintenance, avionics, completions and engineering services and fixed base operations	General Dynamics Corp	Switzerland	United States	2.236
3	Honeywell International Inc (Consumables Solutions Business)	Consumables Solutions Business which distributes fasteners and hardware, and provides logistic services	B/E Aerospace Inc	United States	United States	1.050
4	Tenix Defence Pty Ltd	Company involved in shipbuilding and aerospace parts manufacturing for the defence industry	BAE Systems plc	Australia	United Kingdom	.683
5	Textron Inc (Fluid and power unit)	Fluid and power unit, serving defence and other industries	Clyde Blowers plc	United States	United Kingdom	.645
6	Sparta Inc	Provider of weapons systems planning, analysis and research services and materials research and development services	Cobham plc	United States	United Kingdom	.416
7	Scientific Production Corp Irkut OAO	Aircraft manufacturer	United Aircraft Corp UAC	Russian Federation	Russian Federation	.726
8	Odyssey Industries Inc; Global Tooling Systems Inc	A manufacturer of automotive and aircraft tooling system	Hampson Industries plc	United States	United Kingdom	.322
9	Northrop Grumman Corp (Electro-Optical systems business)	Electro-Optical Systems business which produces night vision and applied optic products	L-3 Communications Corp	United States	United States	.175
10	Weir Strachan & Henshaw	Engineering design specialist, project manager and provider of through-life support for the defence and nuclear industries	Babcock International Group plc	United Kingdom	United Kingdom	.130

Source: PricewaterhouseCoopers Aerospace & Defence Deals 2008 Annual Review

Figure 04: Private equity deals 2000-2008

	2000	2001	2002	2003	2004	2005	2006	2007	2008
Number of PE A&D deals	72	66	84	73	73	65	70	77	31
% of all A&D deals	20%	20%	26%	26%	27%	19%	34%	36%	19%
Value of PE A&D deals (US\$bn)	10.0	7.7	4.8	4.8	5.7	6.7	15.4	16.0	2.4
% of total value of A&D deals	22%	30%	24%	28%	24%	27%	53%	49%	17%

Source: PricewaterhouseCoopers Aerospace & Defence Deals 2008 Annual Review

Figure 05: Top private equity deals, 2008

Rank	Target	Target Description	Bidder	Target Nation	Bidder Nation	Value (\$m)
1	Jet Aviation Management AG	Aviation service company, provides maintenance, avionics, completions and engineering services and fixed base operations	General Dynamics Corp	Switzerland	United States	2,236
2	Brookhouse Holdings Ltd	Manufacturer of tools and components, primarily associated with the aerospace, automotive and autosport industries	Kaman Corp	United Kingdom	United States	85
3	Hydroid LLC	Manufacturer and supplier of autonomous underwater vehicles for military and commercial markets worldwide	Kongsberg Gruppen ASA	United States	Norway	80
4	Woodlawn Manufacturing Ltd	Manufacturer of firearm ammunition	Lone Star CRA Fund	United States	United States	25

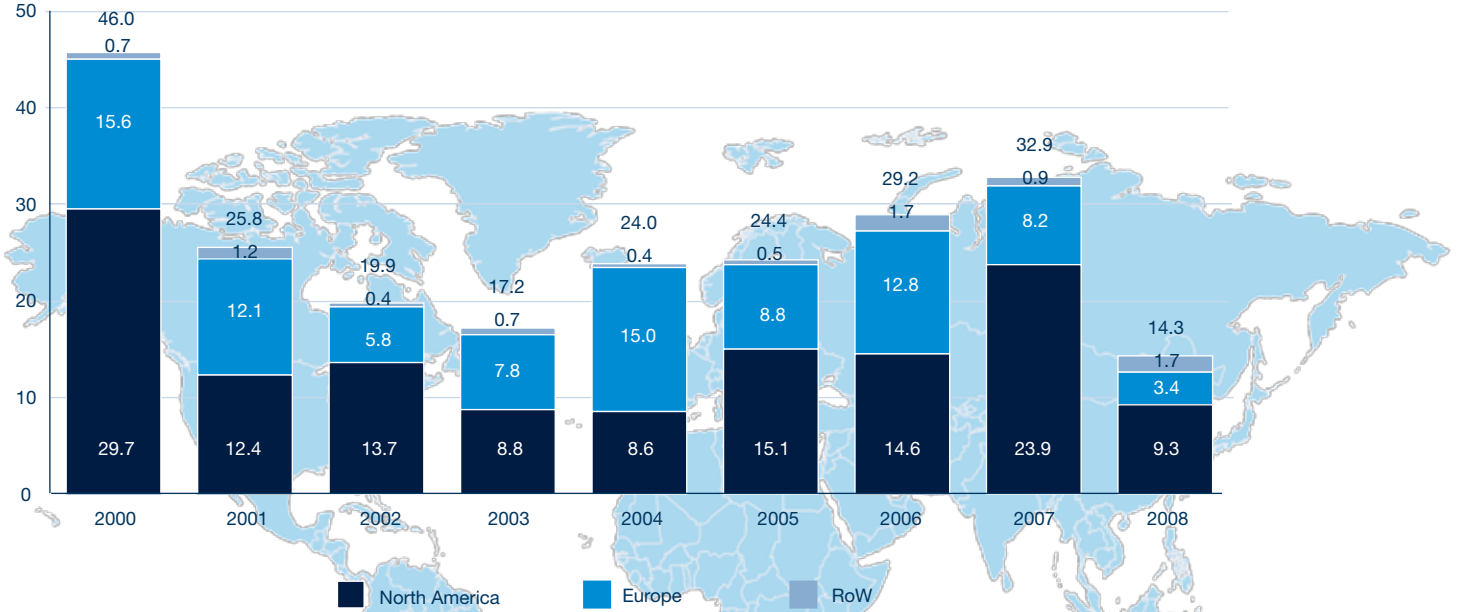
Source: PricewaterhouseCoopers Aerospace & Defence Deals 2008 Annual Review

Out of the total US\$14.3bn invested in 2008, nearly two thirds (65%) was invested in North America, continuing the trend away from years such as 2004 and 2006 when there was a much more balanced profile between Europe and North America (see Figure 6). The Finmeccanica deal ensured that deal flow across the Atlantic, with European companies making US purchases, remained strong. Indeed, at US\$7.3bn, the total value of European transatlantic acquisitions was significantly higher than the US\$2.4bn of deals by North American players investing the other way into European A&D.

Together, North America and Europe accounted for 89% of total deal value (US\$12.7bn of the US\$14.3bn total) and 79% of deal volume (132 of 167 A&D deals worldwide). Transatlantic deals dominated North American and European deal totals. US\$9.7bn of the US\$12.7bn deal value in these two main markets came from transatlantic deals. On both sides of the Atlantic, there were few deals involving a buyer and a target from the same continent. This is nothing new in Europe where the limited scope of the EU market leaves less room for deals and growth, but is a big departure for North America where, in previous years, most deals have involved North American buyers. In 2007, North American investors accounted for 65%, US\$15.5bn, of the US\$23.9bn total North American A&D value. In 2008, due to the impact of the Finmeccanica deal, their share was down to 20% – US\$1.9bn of US\$9.3bn.

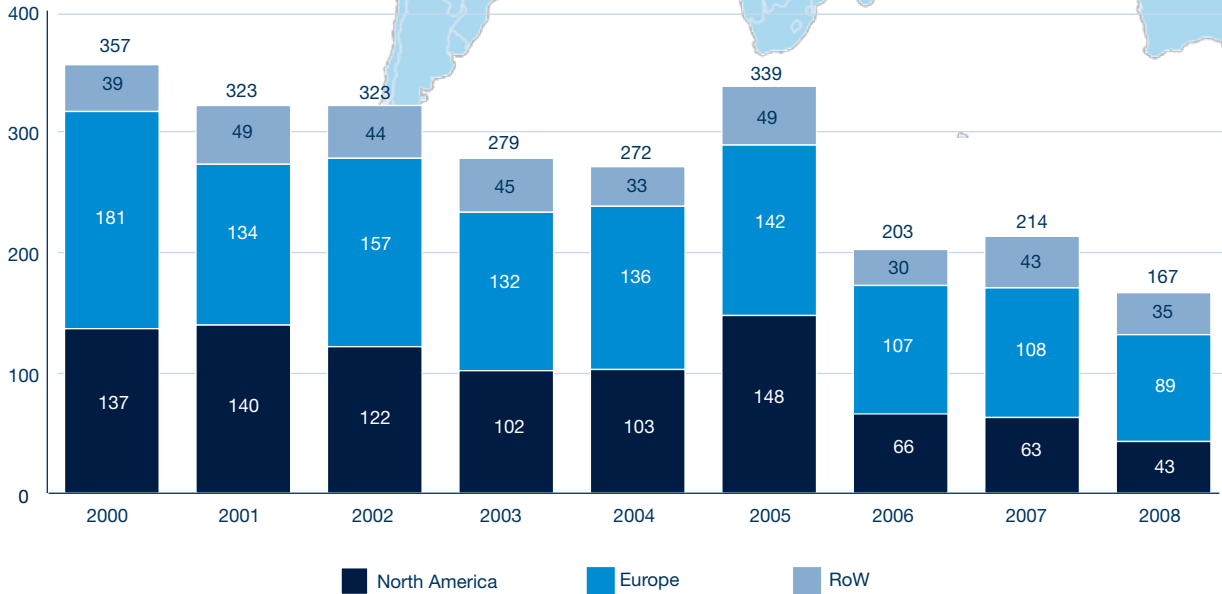
Deal value in the rest of the world in 2008 came close to its record US\$1.7bn level reached in 2006. There was a year on year doubling of the value of deals for targets in the BRIC countries but this was wholly attributable to two deals that formed part of the restructuring of the Russian A&D industry. The rest of the world totals were also buoyed by BAE Systems' US\$683 million purchase of Australian defence business Tenix. Acquisitions by Middle East players in North America, which had accounted for US\$1.8bn of deal value in 2007, dried up in 2008, highlighting the fall in PE activity. We discuss North American, European and the rest of the world transactions in more depth overleaf.

Figure 06: Total disclosed deal value by region (US\$bn)



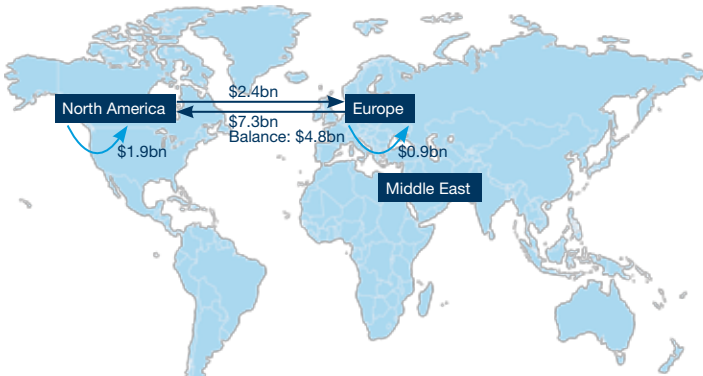
Source: PricewaterhouseCoopers Aerospace & Defence Deals 2008 Annual Review

Figure 07: Total deal volume 2000-2008



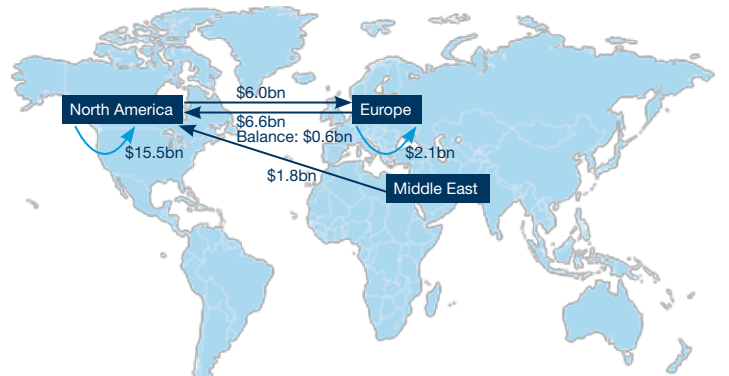
Source: PricewaterhouseCoopers Aerospace & Defence Deals 2008 Annual Review

Figure 08a: Acquisition money flows, 2008



Source: PricewaterhouseCoopers Aerospace & Defence Deals 2008 Annual Review

Figure 08b: Acquisition money flows, 2007



Source: PricewaterhouseCoopers Aerospace & Defence Deals 2008 Annual Review

Total North American target A&D volume fell 17%, from 108 deals in 2007 to 89 in 2008. Total deal value more than halved, down 61% from US\$23.9bn to US\$9.3bn. Four of the top five deals for North American targets were from European bidders, together accounting for US\$7bn of the total US\$7.3bn deal value flowing into North America from Europe.

Apart from General Dynamics' US\$2.2bn purchase of Switzerland-based Jet Aviation (see p15), 2008 deal-making by North American A&D players was very subdued. Indeed the year saw only one other international move by a North American company – Kaman's US\$85 million purchase of UK-based tools and components manufacturer, Brookhouse Holdings. Total deal value involving North American bidders, whether at home or abroad, plummeted 80%, falling from US\$21.5bn in 2007 to US\$4.3bn in 2008.

On the domestic front, the sole North American buyer in the five largest deals for North American targets was B/E Aerospace, the world's leading manufacturer of aircraft cabin interior products and fasteners/consumables, which acquired Honeywell International's Consumables Solutions in a US\$1.1bn deal. The disposal by Honeywell fitted with its strategy of focusing on advance technologies and, indeed, shortly before the sale, the Honeywell aerospace unit had moved for the Californian-based Intelligent Automation Corporation, a supplier of on-board diagnostic systems used in military and commercial aircraft. The Consumables Solutions acquisition added to B/E Aerospace's strategy of growth in its aerospace consumables distribution segment and the company said it also hopes to achieve US\$84 million of sales, distribution, IT and business model synergies in the first three years of the integration.

Finmeccanica's US\$5.6bn purchase of DRS Technologies (see p13) headed the inbound list followed by three, much smaller, purchases by UK companies. The second biggest deal came from Clyde Blowers, a UK based manufacturer and designer of pneumatic conveying systems, which acquired the fluid and power unit of Textron, a US based producer of aircraft, automotive, and industrial products and best known as the manufacturer of Cessna jets. Private equity played a significant part in the US\$645 million deal, although not as direct purchasers but as backers of the Clyde Blowers management team who had built up their own capital fund from PE sources.

The two remaining UK buyers in the top five North American deals list were more familiar A&D names – Cobham and Hampson Industries. Precision engineering, avionics, and flight operations company Cobham acquired Sparta, a US based provider of weapons systems planning, analysis and research services, for US\$416 million. Like Finmeccanica, Cobham said it intended to keep the US management team in place as a strategic business unit. The purchase followed the completed acquisition by Cobham of autopilot manufacturer S-TEC and the announced acquisition of the Lansdale US sensors and antennae business. Together these deals represent a significant stepping-up of the company's presence in the US A&D market. Hampson Industries' purchase, the US\$322 million acquisition of Odyssey Industries and Global Tooling Systems, similarly came on the back of a string of deals by the company for US aerospace engineering targets. The latest purchases give Hampson a significant supplier role in the Boeing Dreamliner programme.

PwC deal spotlight

Finmeccanica flying high in US

Finmeccanica became a significant supplier to the US military in 2008 through its acquisition of DRS Technologies, a manufacturer of a host of defence electronic systems such as thermal weapon and electro-optic sights, tactical computers and workstations, naval electrical distribution on ships, generators, and water purification and environmental control equipment used by deployed forces.

The deal mirrors previous successes of BAE Systems in developing a true 'home market' in the US and demonstrates the 'opening up' of the US defence market to selected foreign primes. DRS reported sales of US\$3.2bn prior to the US\$5.6bn acquisition. More importantly for Finmeccanica, 90% of the acquired growth will be in the US, which is the largest and among the fastest growing defence markets in the world.

In addition to the strong organic growth that DRS is expected to continue to generate, the company is a 'gateway' for Finmeccanica to begin introducing more of its products into the US market. Given Finmeccanica's strong platform presence in tactical airlift aircraft and helicopters, combined with DRS' electronic systems capabilities, there may arise opportunities in the US where DRS can serve as the systems integrator and prime contractor.

Finmeccanica is not a stranger to the US defence market and recently won the Defense Department's C-27A Joint Cargo Aircraft programme based on their aircraft design. Its AgustaWestland division is also teamed with L-3, in providing AW139 medium-lift helicopters to Customs and Border Protection and is developing the US101 – the replacement US presidential helicopter.

Finmeccanica has the ability to bolster DRS with additional research and development funds and the additional opportunities the combination will have for DRS to expand its international sales. Under the deal terms, DRS operates largely independently as a wholly owned subsidiary of Finmeccanica and reports to its own board of directors, consisting mostly of US citizens through the establishment of a Special Security Agreement. Finmeccanica would have responsibility for helping DRS set strategy.

Figure 09: North American A&D target and bidder deal activity

	2007	2008	% Change
North American target			
Number	108	89	(17)%
Disclosed deal value (US\$bn)	23.9	9.3	(65)%
North American bidder			
Number	110	90	(18)%
Disclosed deal value (US\$bn)	21.5	4.3	(80)%

Source: PricewaterhouseCoopers Aerospace & Defence Deals 2008 Annual Review

Activity for European targets was down even more than in North America – deal numbers fell by 32% and the total value of European targets was down 59%, from US\$8.2bn in 2007 to US\$3.4bn in 2008 (see Figure 10). European bid activity was also down, by 25%, although Finmeccanica's purchase of DRS and the activity of other European buyer activity in North America helped to maintain a high level of total bid value which edged up from US\$8.7bn in 2007 to US\$8.9bn in 2008.

US company General Dynamics' US\$2.2bn purchase of Switzerland-based Jet Aviation (see p15) was by far the largest 2008 deal for a European target. The only other US\$100 million plus deal for a European target saw Babcock International, the support services group that is increasing its presence in defence contract work, purchase UK-based nuclear and marine specialist Strachan & Henshaw from the Weir Group for US\$130 million.

The big story in 2008 European A&D deal activity was the series of North American purchases by European companies (see North America and Deal Makers sections). US\$7.3bn of the total US\$8.9bn value of European bidder activity was for North American targets. This was considerably higher than the US\$4.8bn, US\$1.5bn and US\$6.6bn of European acquisition money flowing into North America in 2005, 2006 and 2007 respectively. Indeed, the total value of 2008 European outbound activity for North American targets was a record high for the whole of the decade. European companies need a presence in the US if they are to be global A&D players, hence the momentum for cross-Atlantic acquisitions. The flow of deals in 2008 follows similar deals in previous years such as BAE Systems' US\$4.5bn purchase of Armor Holdings.

Figure 10: European A&D target and bidder deal activity

	2007	2008	% Change
European target			
Number	63	43	(32)%
Disclosed deal value (US\$bn)	8.2	3.4	(59)%
European bidder			
Number	64	47	(25)%
Disclosed deal value (US\$bn)	8.7	8.9	2%

Source: PricewaterhouseCoopers Aerospace & Defence Deals 2008 Annual Review

PwC deal spotlight

General Dynamics extends corporate jet footprint

Aerospace firm General Dynamics Corporation moved deeper into the corporate jet market, buying Jet Aviation of Switzerland from its private equity owners for US\$2.25 billion. Jet Aviation was founded in Switzerland in 1967 and is one of the world's leading business aviation services companies.

Approximately 5,600 Jet Aviation employees cater to clients' needs from 25 airport facilities throughout Europe, the Middle East, Asia and North and South America. Services provided include maintenance, repair and overhaul; completions and refurbishments; engineering; fixed base operations (FBO); aircraft management, flight support and global executive-jet charter services; and aircraft sales, acquisitions and personnel services.

While General Dynamics is perhaps best known for its tanks, ships, submarines and other military equipment, it has significantly expanded its aerospace unit, Gulfstream, in recent years and now expects its fleet of business jets to double in the next decade to roughly 30,000 aircraft. International orders at Gulfstream outpaced US sales for the first time in 2007 and the company recently introduced its largest and widest-ranging jet, the G650. Orders remain strong for high

end, long range business jets such as the Gulfstream series and Bombardier's Global Express series.

Jet Aviation generates roughly 60 percent of its sales in Europe, the Middle East and Asia. By comparison, General Dynamics' aerospace unit, which includes Gulfstream, has 12 service centres, with all but one located in the US.

The deal allows General Dynamics to take advantage of Jet Aviation's strong presence in the rapidly growing Middle East region. Three years ago, for example, Jet Aviation opened a 24-hour executive jet service centre at Dubai International Airport. The airport has grown into a key transit hub in recent years thanks to the Gulf city's growing prominence

14 Rest of the world

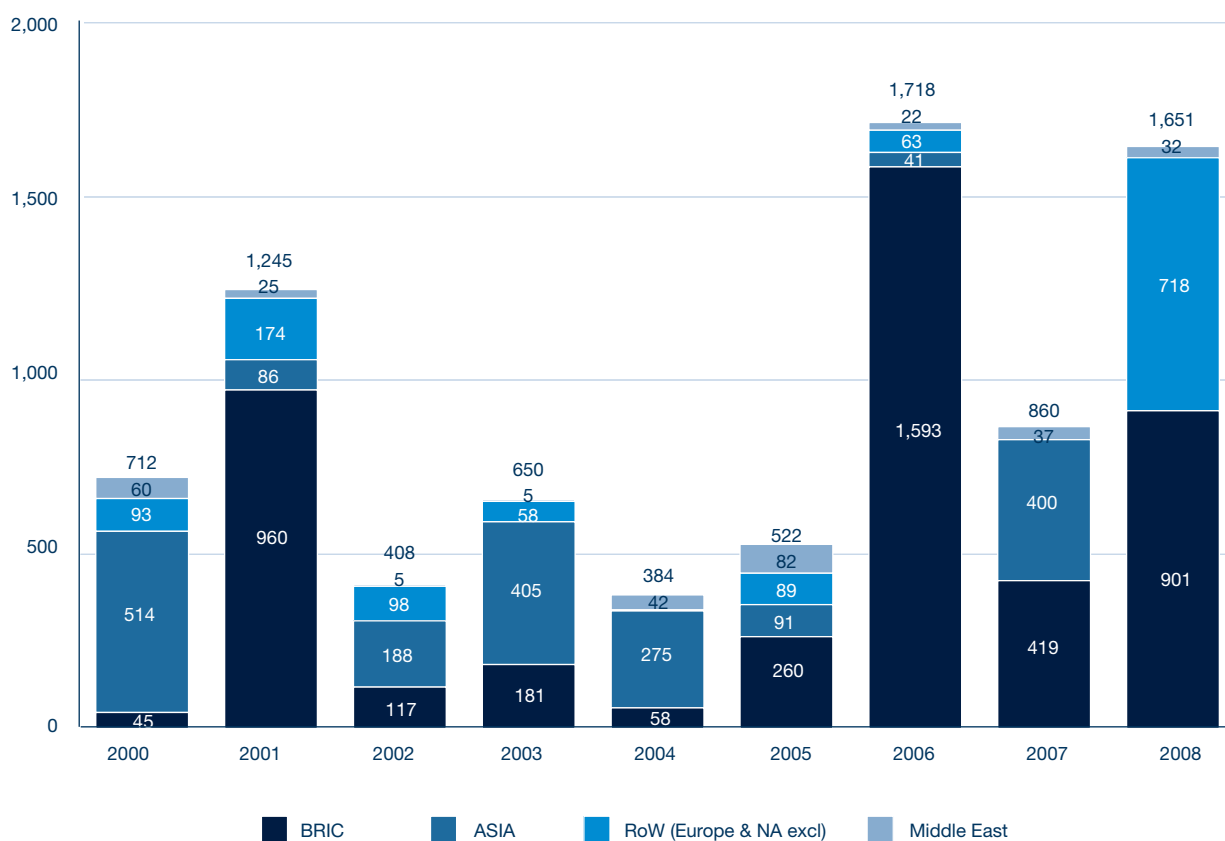
Year-on-year A&D deal volume for targets in the rest of the world dropped 19%. However, the value of disclosed deals nearly doubled, from US\$0.9bn in 2007 to US\$1.7bn in 2008, just short of the 2006 record high (see Figure 11). In 2006, it was deals for targets in the BRIC countries that fuelled the totals with the US\$997 million stock swap of shares in Brazilian aerospace company Embraer leading the way. In 2008, however, there was negligible underlying BRIC activity. Instead, it was two related deals totalling US\$726 million, connected with the restructuring of the Russian aerospace industry, that pushed deal values up.

The remainder of rest of the world deal value was largely attributable to BAE Systems' US\$683 million purchase of Australian defence business Tenix. The BAE Systems purchase advances what BAE describes as its 'multi-home market business focus', adding Australia to its other 'home markets' which include the UK, US, South Africa and Saudi Arabia. The company is integrating Tenix Defence with its existing BAE Systems Australia operation. The Tenix acquisition adds a major naval business to the BAE portfolio and strengthens the company's land capability options for equipping and supporting the Australian Defence Force. Thales has had a similar strategy, calling it 'multidomestic' development, including the recent purchase of ADI in Australia. Many such new market expansions start with partnerships with local industry which are later dissolved, with Thales taking control or full ownership of the local subsidiary once local customers have recognised its legitimacy and capabilities.

The two Russian deals were the latest in a series of restructuring moves in Russia to develop the United Aircraft Corporation (UAC) into a national A&D champion. UAC was created in February 2006 by Russian President Vladimir Putin. The goal is to develop a world class company in order to be able to compete on a world stage, in particular in the regional aircraft market. Both 2008 deals involved the acquisition of Scientific Production Corporation by UAC.

On the bidder front, total value was inflated by the effect of the two Russian deals and underlying activity by BRIC and rest of the world bidders was negligible (see Figure 12).

Figure 11: Rest of the world deal value (US\$m), 2000-2008



Source: PricewaterhouseCoopers Aerospace & Defence Deals 2008 Annual Review

Figure 12: Rest of the world A&D target and bidder deal activity

	2007	2008	% Change
Rest of world target			
Number	43	35	(19)%
Disclosed deal value (US\$bn)	0.9	1.7	92%
Rest of world bidder			
Number	40	30	(25)%
Disclosed deal value (US\$bn)	2.8	1.1	(61)%

Source: PricewaterhouseCoopers Aerospace & Defence Deals 2008 Annual Review

16 Looking ahead

A constrained financing environment, continued economic slowdown and economic recession in some countries will provide the background for A&D deal-making in the coming period. In the sector itself, concerns about global capacity, cancelled orders, flatter defence spending and technological challenges associated with the manufacture of the new generation of super wide-bodied jets will influence deal-making. The cyclical slowdown in civil deliveries expected in 2011 is kicking in much sharper and sooner.

In this context, deal-making is likely to be very subdued during 2009 with the drying-up of deals in the last quarter of 2008 setting the tone for 2009. As well as the market environment concerns outlined above, lack of leverage will be a key factor constraining buyers, corporate as well as private equity. Conservation of cash reserves will be a priority for many companies. More cash will be needed for vendor financing with both Boeing and Airbus, for example, saying they intend to step up such financing. The latter has announced that the amount of cash set aside for this purpose could double in 2009.

Even if they are in a position to make purchases, companies and investors will be reluctant to buy until they are convinced valuations have bottomed out. Some smaller businesses, who may have scaled-up to meet expected demand, may find the tide has gone out and left them in need of buyers. Forced selling is unlikely to be as widespread feature of deal-making as in some other industries, although the incidence of smaller companies forced into deals is likely to increase. Canadian and French company Mecachrome, for example, has already come close to bankruptcy and has had to reorganise with new financing commitments under the protection of the French and Canadian courts.

Private equity deal strategies will change. The highly leveraged buy-outs of previous years are likely to remain absent. Where it plays a role, private equity investments are much more likely to be undertaken in concert with management teams, through specifically designed funds, minority investments or joint ventures. North America will continue to be a key market for European companies seeking expansion. Such moves are strategic and will not necessarily be constrained by exchange rate trends and, indeed, any continuing dollar strength will boost profitability.

The jury is out on the optimal development and manufacturing model for new platforms. The expected supply chain shake-up, with companies favouring outsourcing, has been only partly proven as companies encountered a range of problems. All eyes will be focused on how the Boeing 787 delivers and, in Europe, on Airbus' A400M programme which is running late. M&A activity may be influenced by the possibility of a 'back to basics' approach for future platforms with a degree of vertical integration returning to favour. In Europe, sub-contractors are often small and, as a result, slow consolidation of the supply chain is taking place with larger players and investment funds buying smaller players. Away from manufacturing, the growth of outsourcing will continue to support interest in service sector deals, including in the armed forces sector in Europe.

The focus on security and advanced technological developments, in response to concerns over terrorism, economic resilience, cyber-crime, piracy and other threats, will continue to strengthen and provide a spur to deal-making for companies specialising in the technology and security fields. In October 2008, for example, SAFRAN announced the purchase of Motorola's biometric business unit. The market will continue to remain robust where there are opportunities to acquire niche technologies that can create future growth opportunities in the security sphere. The French defence white paper, for example, will reinforce this trend. In the US, defence corporates are also looking for targets with long-term programme backlog that appear to be viable under the new administration.

Global Aerospace & Defence Deals Team

Neil Hampson

Global Aerospace & Defence Leader
Tel: +44 (0) 20 7804 9405
Email: neil.r.hampson@uk.pwc.com

Matthew Alabaster

Director – Aerospace & Defence, UK
Transaction Services
Tel: +44 (0) 20 7804 9642
Email: matthew.alabaster@uk.pwc.com

Guillaume Rochard

France Aerospace & Defence Leader
Transaction Services
Tel: +33 (0) 1 56 57 8208
Email: guillaume.rochard@fr.pwc.com

Andrew Cristinzio

Partner – Aerospace & Defence US
Transaction Services
Tel: +1 (703) 918 1474
Email: andrew.cristinzio@us.pwc.com

Chandra Chudamani

Director – Aerospace & Defence US
Transaction Services
Tel: +1 (703) 918 1482
Email: chandra.chudamani@us.pwc.com

Miriam Pozza

Partner – Aerospace & Defence Canada
Transaction Services
Tel: +1 (514) 205 5286
Email: miriam.pozza@ca.pwc.com

Darren Jukes

Director – Aerospace & Defence UK
Corporate Finance
Tel: +44 (0) 20 7804 8555
Email: darren.jukes@uk.pwc.com

Katrine Ellingsen

Global Aerospace & Defence
Marketing Director
Tel: +1 (514) 205 5066
Email: katrine.ellingsen@ca.pwc.com

Territory Contacts

Brazil

Augusto Assuncao
Tel: +55 (19) 3794 5408
Email: augusto.assuncao@br.pwc.com

Canada

Mario Longpré
Tel: +1 (514) 205 5065
Email: mario.longpre@ca.pwc.com

Canada

Katrine Ellingsen
Tel: +1 (514) 205-5066
Email: katrine.ellingsen@ca.pwc.com

CEE

Stewart Blackburn
Tel: +48 (22) 746 7143
Email: stewart.blackburn@pl.pwc.com

CEE

Andrzej Karkoszka
Tel: +48 (22) 746 7142
Email: andrzej.karkoszka@pl.pwc.com

CEE

Adam Bergmann
Tel: +48 (22) 746 7141
Email: adam.bergmann@pl.pwc.com

France

Guillaume Rochard
Tel: +33 156 57 8208
Email: guillaume.rochard@fr.pwc.com

Germany

Jürgen Seibertz
Tel: +49 211 981 2845
Email: juergen.seibertz@de.pwc.com

India

Dhiraj Mathur
Tel: +91 11 4115 0309
Email: dhiraj.mathur@in.pwc.com

Italy

Corrado Testori
Tel: +39 (06) 5702 52442
Email: corrado.testori@it.pwc.com

US

Skip (Daniel) McConeghy
Tel: +1 (312) 298 4343
Email: daniel.mcconeghy@us.pwc.com

US

Scott Thompson (Assurance)
Tel: +1 (860) 240 2153
Email: scott.thompson@us.pwc.com

US

Tim Slapnicka (Assurance)
Tel: +1 (860) 241 7420
Email: tim.slapnicka@us.pwc.com

US

James W Thomas (Advisory)
Tel: +1 (202) 414 1370
Email: james.w.thomas@us.pwc.com

US Aerospace & Defence Marketing

Carol J Zielinski
Tel: +1 (312) 298 3199
Email: carol.j.zielinski@us.pwc.com

Acknowledgements

Data analysis for this industry summary was provided by Ben Mitchell in the PwC UK Corporate Finance Group, and the report was written by Dominic Byrne (The Bigger Picture Consultancy). Thanks go to Andrew Cristinzio, Barry Jaber, Chandra Chudamani and Guillaume Rochard for their contributions to developing the A&D industry perspectives presented in this paper. Thanks also to Erica McEvoy and Katrine Ellingsen for providing marketing support to launch the paper and to our assurance design team for design and production.



This report cover is printed on FSC Profisilk 250gsm.

The text pages are printed on FSC Profisilk 150gsm.

PricewaterhouseCoopers has taken all reasonable steps to ensure that the information contained herein has been obtained from reliable sources and that this publication is accurate and authoritative in all respects. However, it is not intended to give legal, tax, accounting or other professional advice. If such advice or other expert assistance is required, the services of a competent professional should be sought.

© 2009 PricewaterhouseCoopers. All rights reserved. 'PricewaterhouseCoopers' refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

PricewaterhouseCoopers (www.pwc.com) provides industry-focused assurance, tax and advisory services for public and private clients. More than 120,000 people in 144 countries connect their thinking, experience and solutions to build public trust and enhance value for clients and their stakeholders. PricewaterhouseCoopers refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

Important notice for US residents: In the US, corporate finance services are provided by PricewaterhouseCoopers Corporate Advisory & Restructuring LLC. PricewaterhouseCoopers Corporate Advisory & Restructuring LLC is owned by PricewaterhouseCoopers LLP, a member firm of the PricewaterhouseCoopers Network, and is a member of the FINRA and SIPC. PricewaterhouseCoopers Corporate Advisory & Restructuring LLC is not engaged in the practice of public accountancy. For US residents requiring further information on corporate finance related services, please contact our registered FINRA Broker Dealer within the US, PricewaterhouseCoopers Corporate Advisory & Restructuring LLC, who can be contacted directly at rakesh.r.kotecha@us.pwc.com, telephone +1 312 298 2895, fax +1 813 375 7416.

*connectedthinking is a trademark of PricewaterhouseCoopers LLP.