

Mission control

Third-quarter 2009 aerospace and defense industry mergers and acquisitions analysis

Climate change: Shifting the business environment beyond corporate responsibility



Welcome to *Mission control*, PricewaterhouseCoopers' (PwC) quarterly analysis of mergers and acquisitions (M&A) in the global aerospace and defense industry. In addition to a detailed summary of M&A activity in the third quarter of 2009, we supplement this issue with a special report addressing the impact that prospective energy and climate policies may have on business transactions. Included is a discussion about the role of cap-and-trade in climate change legislation, how the deal market is responding, and brand and reputation considerations.

Special report: Sorting out the carbon effect on deal activity

Until recently, the impact of climate change policy on the deal market was barely on the radar of most businesses. But as national policy and emerging international agreements requiring action on greenhouse gas emissions begin to take shape, aerospace and defense (A&D) companies must pay closer attention to the economic consequences of the proposed legislation when planning and executing deal strategy. They must also think about how competitors doing business in nonregulated countries could affect their businesses.

Regardless of the ultimate policy design, the fact remains: when greenhouse gases (GhGs) are regulated, the cost of carbon will have a measurable impact on business transactions, from capital allocation decisions to M&A strategy. Although a significant amount of uncertainty exists in the policy environment, it is possible that businesses operating in the US could face the imposition of constraints on GhG emissions.

Meanwhile, the European Union continues to push ahead of the United States in the regulation of carbon emissions and recently included aviation in the European Emissions Trading Scheme (EU ETS). Starting in 2012, operators will be required to surrender one allowance per metric ton of CO₂ emitted on a flight to and from (and within) the EU. The regulation covers passenger, cargo, and noncommercial flights no matter where an operator is based. Noncomplying operators may face penalties or might even be banned from operating in the EU.

As a cap-and-trade system for aviation begins in Europe, and as carbon emission regulations evolve in the US, A&D companies will need to assess their carbon footprints and learn how to manage carbon to either minimize the impact of any resulting liability or maximize the value of any resulting asset. They will need to be able to identify what will be financially material and what they will need to disclose. They also will need to be able to distinguish a risk from an opportunity.

A&D companies that participated in the 2009 Carbon Disclosure Project said opportunities from climate change regulation could arise from increased use of advanced technology such as satellites for helping model and track the physical impacts of climate change.¹ A&D companies that build more efficient aircraft and propulsion systems could also position themselves to gain competitive advantage. According to investment banking and advisory firm Seabury Group, airlines are looking for a 15 percent to 20 percent reduction in operating costs and emissions reductions, and 20- to 30-decibel noise reductions when purchasing new aircraft. One critical technology in generating these reductions is jet engines. Another is the development of advanced composite materials.²

Regardless of what happens to climate change policy, many A&D companies have started to take action to minimize their own internal carbon footprint and capitalize on opportunities. By embarking on “no regret” initiatives—initiatives the company would want to complete regardless of whether the action were mandated—A&D companies will be prepared to deal with possible reporting, compliance, and audit requirements relating to carbon emissions. “No regret” initiatives include voluntary company actions, such as reducing energy costs or improving process efficiencies that have the added benefit of reducing pollution.

¹ Carbon Disclosure Project 2009 S&P500 With Industry Snapshots

² Standard & Poor's Industry Surveys, Aerospace & Defense, July 2009

Will cap-and-trade be a part of climate change legislation?

On June 26, 2009, the House of Representatives approved the Waxman-Markey bill, which features a cap-and-trade program. The bill faces opposition in the Senate, where strong geopolitical concerns from both Democrats and Republicans may have a more significant impact on the bill's requirements. Additionally, the recent emphasis on US healthcare reform along with a persistent weakness in the labor market has shifted the focus away from climate change legislation.

As interest in climate policy wanes, public concerns about the environment continue to grow. The Obama administration is also under pressure to offer some form of "green" legislation to the United Nations Framework Convention on Climate Change in Copenhagen, Denmark in December 2009.

Meanwhile, in September 2009, Senators John Kerry and Barbara Boxer introduced a bill that includes a cap-and-trade system that would require a 20 percent reduction from 2005 levels of emissions, compared with a 17 percent cut included in the Waxman-Markey bill. The Environmental Protection Agency (EPA) also is taking steps toward greenhouse gas regulation. In March 2009, the EPA set in motion a rule that would require certain companies—including suppliers of fossil fuels and industrial chemicals, manufacturers of motor vehicles and engines, and other large, direct emitters—to report their greenhouse gas emissions regularly beginning in 2011. The final Mandatory Reporting of Greenhouse Gases Rule was signed by the EPA administrator on September 22, 2009.

The EPA's endangerment finding³ ensures that legislative inaction by the Senate on a cap-and-trade bill does not preclude mandates to reduce greenhouse gases. However, PwC believes A&D companies may find cap-and-trade

legislation a preferable solution to the EPA regulation of greenhouse gases under the Clean Air Act. In our view, an EPA regulation has the potential to force companies to meet specific performance standards on emission controls based on the best available technology. In contrast, a cap-and-trade system allows participants to seek the most cost-effective measures to reduce carbon, which could lower compliance costs in aggregate.

Climate change legislation can be a driver behind deal valuations

Although pending climate change legislation should be considered in any deal, it is becoming one of the drivers behind certain valuations—especially in heavy-emitting sectors. The impact of climate change legislation increasingly plays a part in the valuation of a company and must be properly assessed during due diligence to understand future climate change compliance costs and possible benefits resulting from trading credits.

Understanding how a target's business is affected by climate change should be an integral part of an acquirer's risk management strategy and due diligence. When deciding whether to provide financing, financial institutions have started assessing the possible effects of climate change policy on a business. Companies looking to complete an acquisition should do the same. In more and more deals, companies should thoroughly evaluate the potential impacts of climate change legislation on earnings, cash flow, and target valuation, as well as any opportunities for cost reductions through synergies. Similarly, PwC has observed that on a number of occasions acquisitions have been made without full disclosure of the position of any local "carbon permit liability" (e.g., EU ETS) related to the assets being transacted. This has led to the sale of assets without retention of the related emissions credits by the parent company and a subsequent liability arising to the acquirer.

³ US Environmental Protection Agency, April, 2009

A climate change call to action

In addition to assessing the effect climate change has on valuations, companies must consider reputation, branding, and stakeholder interest. While climate change affects various companies in different ways, all organizations are affected by environmentally aware stakeholders including investors, communities, employees, and nongovernment organizations (NGOs). Because the democratization of information has the ability to rapidly influence public perception of a company's brand, devising an effective strategy on climate change appears to be essential in managing company reputation.

Alongside brand and reputation considerations, new technology appears essential to A&D companies seeking competitive advantage as they transition to a low-carbon economy. Leaders are working on building products with low-carbon performance to differentiate their companies in the market. US carriers, in particular, have demanded more fuel-efficient aircraft. Boeing responded by developing the 787, which the company says is 20 percent cheaper to operate and a third of the cost to maintain than its earlier planes of equal size.⁴

To comply with the EU ETS scheme, aircraft operators need to have reliable systems in place to generate benchmark data from 2010. The related monitoring plans were to have been submitted no later than August 31, 2009; however some EU member states have extended this (the UK revised deadline is November 12, 2009) to give airlines sufficient time to prepare their plans. The benchmark data will be used to determine the number of free allowances for nine years (2012-2020), making it worth up to several billion euro for some airlines.

The challenge for companies is to anticipate how they will operate in a carbon-constrained environment by discerning whether their product inventories are right, assessing the degree of exposure that those products have to climate change regulation, and developing a least-cost compliance strategy.

To A&D company executives and corporate development teams, climate change is not about the science; it's about the need to appreciate how climate change regulation affects their businesses, the information they report, and the impact it may have on deal value.

⁴ First Research, Aerospace Products and Parts Manufacture, Oct. 5, 2009

Perspective: Thoughts on deal activity in the third quarter of 2009

The global financial crisis continues to severely constrain both US and non-US aerospace deal activity. While the bulk of economic metrics remained weak, there were signs during the third quarter that the deal environment may have reached a turning point. Our analysis revealed that the pace of third-quarter deal activity (measured by number and total value of deals with disclosed values of at least \$50 million) declined on a year-over-year basis, as was the case for both the first and second quarters. However, compared to the first and second quarters of 2009, deal activity in the third quarter showed a marked improvement, both in terms of the number of deals and in particular, deal value.

In contrast to the first half of the year, which experienced five deals greater than \$50 million with a total value of \$484.4 million, the third quarter alone produced six deals greater than \$50 million with a total value just under \$2 billion. Two of the six deals were above the \$500 million threshold. On July 7, Boeing announced it was acquiring a facility of Vought Aircraft Industries for approximately \$1 billion. Later in the quarter, on September 24, BAE Systems agreed to acquire the remaining 45 percent stake in BVT Surface Fleet Ltd., from its joint venture partner VT Group, for \$565 million. The Boeing and BAE Systems deals indicate that companies continue to focus on acquisitions that either complement current strategic initiatives and/or solidify current operational and financial positions and are steering clear of more risky acquisitions in new and uncharted areas. When considering total deals (not just those greater than \$50 million), the average deal size continues to drop. The annualized total deal value for 2009 is \$4.2 billion. This represents a decrease of approximately 79 percent when compared to the total deal value of \$19.7 billion for 2008. Interestingly, while deal size continues to drop, the A&D market is experiencing the exact opposite relative to the number of deals. On an annualized basis, the number of deals experienced in 2009 is 267, a 4 percent increase over 2008.

While the market has experienced some signs of life regarding larger deals, we believe that small currently remains the name of the game. In the near term, we anticipate a limited amount of large deal activity in the A&D sector and a steady or increasing level of mid-market deal activity as buyers and sellers become more comfortable operating in today's changed financial and economic environment. Until the credit markets become readily accessible, middle-market activity, distressed deals, and minority interest investment will likely continue to account for the majority of deals. We believe strategic impetus will continue to drive activity in the near term as financial investor appetite remains constrained and as companies exploit opportunities to acquire assets that make their businesses stronger through building density in current markets, enhancing their supply chains, or filling gaps in their product lines.

Even as macroeconomic fundamentals begin to improve, a sustained global economic recovery seems essential for a significant increase in A&D deal activity involving transactions greater than \$50 million. In the current environment, companies that will be best positioned to benefit from mergers and acquisitions will continue to be those with strong and defensible business models and favorable capital positions.

NOTE: General Dynamics' acquisition of Axsys Technologies on September 1, for \$643 million was not captured by our methodology of tracking deal activity. Axsys Technologies is not classified as an A&D company.

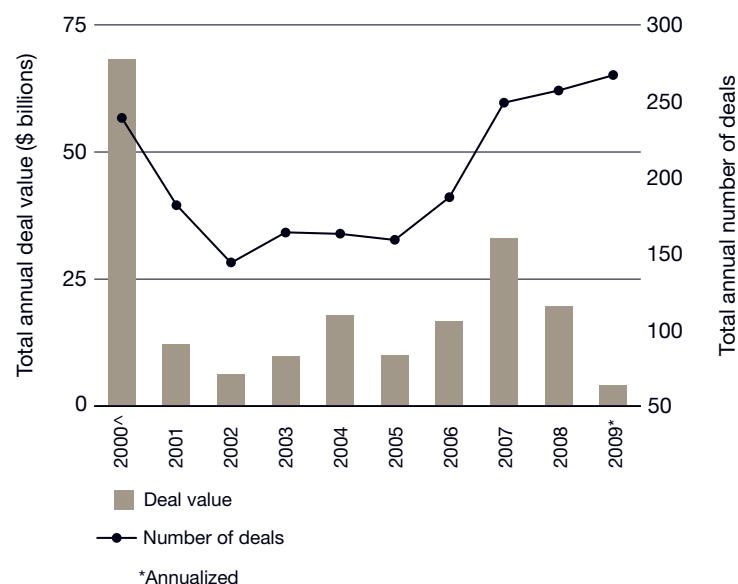
Commentary

Deal totals

The pace of deals experienced in 2008 slightly exceeded those from 2007. This trend continues into 2009, with an annualized total number of deals of 267, a 4 percent increase over 2008. This compares to 249 and 257 in 2007 and 2008, respectively. However, while the total absolute number of deals continues to increase, the total value of deals continues to decrease. The annualized value of deals for 2009 is \$4.2 billion, a decrease of approximately 79 percent compared with 2008's total deal value of \$19.7 billion. The current value of total deals lies below the lows experienced in 2002 where the total deal value was \$6.2 billion.

Interestingly, while year-over-year total deal values have decreased sharply, sequentially, deal values have started to pick up in 2009. Total deal values have increased over the past three quarters, with the third quarter experiencing two deals greater than \$500 million.

Historical transaction value and volume



Historical deal value and volume (1989-2009*)

	2000 [^]	2001	2002	2003	2004	2005	2006	2007	2008	2009*
Total number of transactions	239	182	144	164	163	159	187	249	257	267
Total disclosed value of transactions	68.17	12.10	6.19	9.77	17.93	9.96	16.63	32.98	19.73	4.18

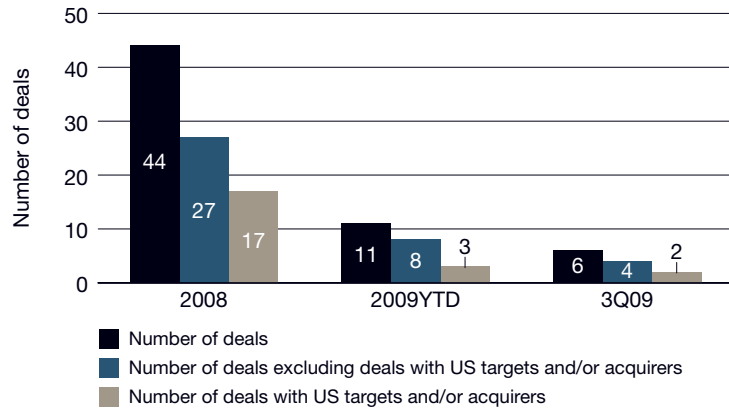
* Annualized

[^] 2000 - Includes the withdrawn offer of \$45 billion from GE for Honeywell

	2007				2008				2009		
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q
Transaction volume	69	50	53	77	60	73	52	72	58	78	64
Transaction value (US\$ bil)	11.32	9.02	5.62	7.02	3.50	8.59	4.51	3.13	0.28	0.66	2.20
Avg. transaction value (US\$ mil)	164.0	180.4	106.0	91.2	58.3	117.7	86.7	43.5	4.8	8.5	34.4

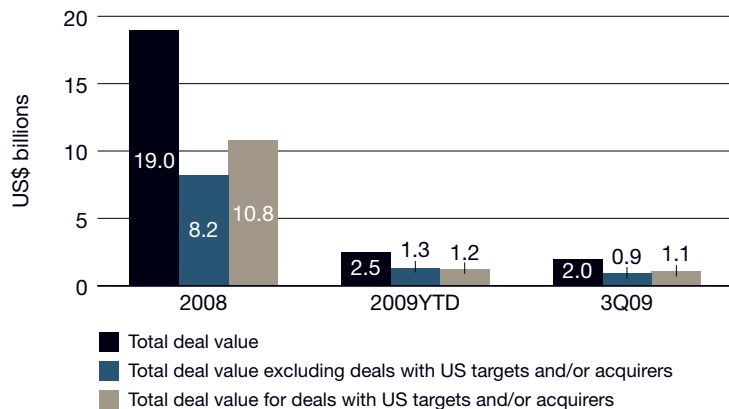
Deal activity by number of deals

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



Deal activity by total deal value

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



Deal activity exhibits sequential improvement

For the year to date 2009, the pace of activity for deals greater than \$50 million compared with the same period a year ago continues to decline. As of September 30, the number of deals in 2009 was 11. This compares to 36 deals in 2008 over the same period. However, on a sequential basis, the number of deals has improved considerably. For the first half of 2009, there was one A&D sector deal over \$50 million in the first quarter and four deals greater than \$50 million in the second. The third quarter alone produced six deals with values at or greater than \$50 million, more than the first and second quarter combined. The improvement in the rate of deal announcements can be attributed to an improvement in the pace of cross-border deals and deals involving non-US entities.

Similar to the trend in the number of deals, the total value of announced transactions worth \$50 million or more also improved quarter over quarter, increasing from \$433 million in the second quarter to approximately \$2 billion in the third quarter. Year-to-date deal activity has remained constrained relative to a year ago, due in part to the continuing limited activity by financial investors and persistent (although improving) weakness in the capital markets. Indeed, capital markets were showing signs of improvement toward the end of the third quarter with an increased number of offerings and signals of future offering intentions. We expect that this level of activity will likely remain consistent in the near to medium term, as companies and investors look for liquidity and exit strategies. Total deal value for deals worth \$50 million or more through the third quarter is \$2.5 billion, compared with \$16.1 billion for the same period in 2008, an 84.5 percent decline.

Deal values continue to decline

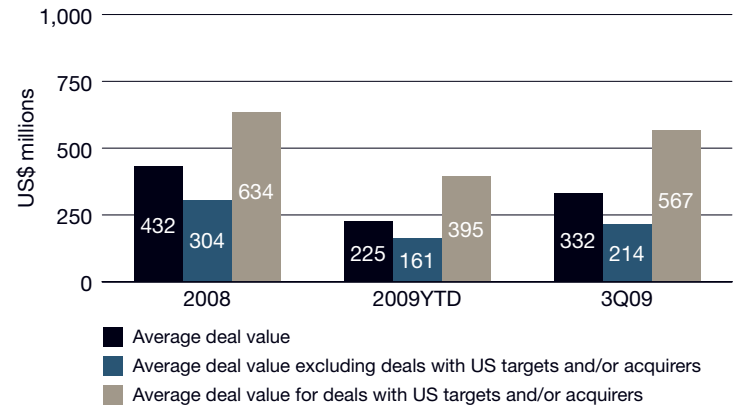
The average deal value of transactions greater than \$50 million has dropped significantly within the A&D industry compared with a year ago. Though, as previously mentioned, the third quarter experienced two deals greater than \$500 million. The large deal activity during the third quarter is the primary driver of the improvement in average deal value for the quarter. The average value of deals announced during the third quarter was \$332 million, which compares with \$225 million for the first three quarters of 2009. Excluding the two large deals, the deal value for the third quarter is \$106 million.

Notwithstanding the increased large deal activity in the third quarter, most deal activity remains concentrated in smaller, middle-market deals and deals with undisclosed values. In upcoming quarters, the proportion of deal activity attributable to larger deals may gradually improve as credit markets continue to ease and rising stock markets provide strategic acquirers with the financing necessary to engage in larger deals.

When comparing US and non-US deal activity above \$50 million to 2008, US companies continue to account for a larger percentage of overall deal value and larger average deal size. During the third quarter, deals that involved US entities (either target or acquirer) accounted for 57 percent of the total value with an average deal size of \$567 million. This compared to the non-US average deal size of \$214 million.

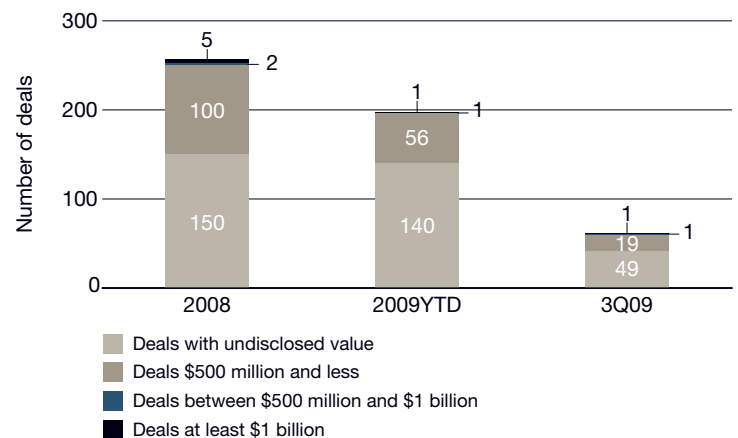
Deal activity by average deal value

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



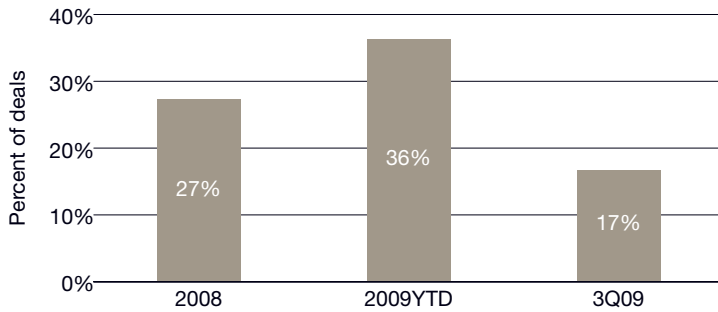
Deal activity by number and range of deal value

Measured by number of announced deals



Minority stake purchases

Measured by percent of deals worth \$50 million or more for less than 50% ownership

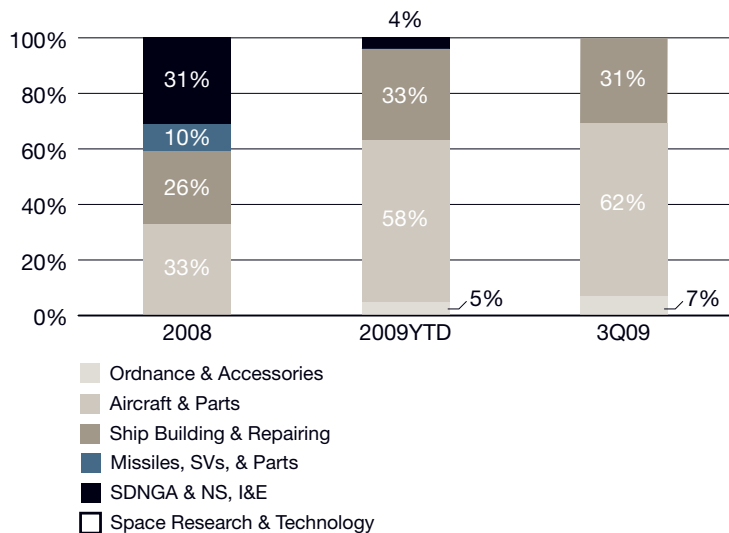


Acquirers continue to seek creative alternatives

While the percent of minority stake purchases slowed in the third quarter, year-to-date minority stake purchases increased compared with 2008. Year-to-date minority purchases represent 36 percent of deals greater than \$50 million. This compares with 27 percent in all of 2008. This trend, when considered in conjunction with the current credit market constraints and overall economic uncertainty, is likely to continue in the near term, as buyers and sellers complete deals through more creative structures, including minority stake purchases and joint ventures.

Deal activity by aerospace and defense mode

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



Aircraft and parts deal values significantly increase as percentage of deals

Year-to-date, 58 percent of deals (measured by volume) were for aircraft and parts manufacturers versus 33 percent in 2008. This significant increase was driven by Boeing's acquisition of a Vought Aircraft Industries facility and BAE's acquisition of the remaining stake of BVT Surface Fleet Ltd., the two large deals experienced during the quarter. The deals for ship building and repairing manufacturers increased to 33 percent from 26 percent in 2008 as the deal mix primarily shifted away from missiles, space vehicles (SVs), and parts, and SDNGA & NS, I&E⁵. The third-quarter activity supported the overall year-to-date shift mentioned previously, with a relative increase in aircraft and parts, and no activity in missiles, SVs, and parts or SDNGA & NS, I&E.

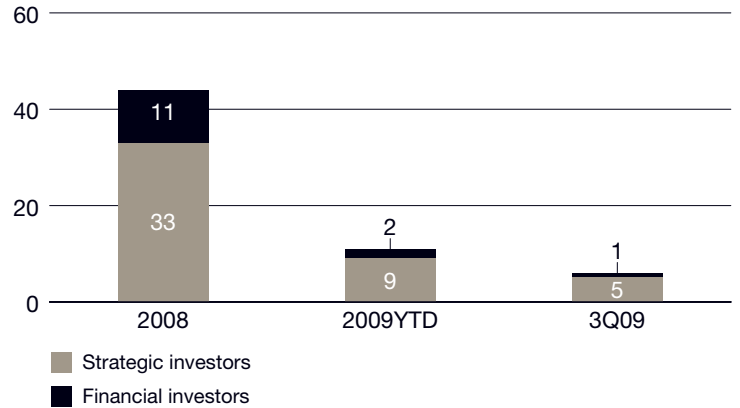
⁵ SDNGA & NS, I&E - Search, Detection, Navigation, Guidance, Aeronautical, and Nautical Systems, Instruments, and Equipment

Financial buyers remain focused on portfolio companies rather than new acquisitions

The proportion of deals announced by financial investors continued to decrease as a percentage of total participation relative to strategic investors. Financial investors accounted for 25 percent of deals with values greater than \$50 million in 2008. This percentage dropped to 18.2 percent for 2009 year-to-date and decreased in the third quarter with just 16.7 percent of deals attributed to financial investors. During the third quarter financial investors continued to invest a large portion of their efforts in providing improvement, support, and guidance to existing portfolio companies, rather than in seeking new acquisitions. With signs of improvement in the capital markets (and, thus, the potential for exit opportunities), we would expect an increase in the near- to medium-term in activity by financial buyers from the levels experienced in the third quarter.

Deal activity by investor group

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



Summary of large deals

Large deals in 2008 (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
May	DRS Technologies Inc	United States	Finmeccanica SpA	Italy	Completed	5.14	SDNGA & NS, I&E
Aug	Jet Aviation International SA	Switzerland	General Dynamics Corp	United States	Completed	2.25	Aircraft & Parts
Oct	Thales SA	France	Dassault Aviation SA	France	Completed	1.98	Missiles, SVs, & Parts
Jun	Honeywell International Inc- Consumable Solutions Business	United States	BE Aerospace Inc	United States	Completed	1.06	Aircraft & Parts
Jan	Malaysia Marine & Heavy Engineering Sdn Bhd	Malaysia	Ramunia Holdings Bhd	Malaysia	Withdrawn	1.06	Ship Building & Repairing

Large deals in 2009 (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
Jul	Vought Aircraft Industries Inc - Facility, North Charleston, SC	United States	Boeing Co	United States	Completed	1.00	Aircraft & Parts

Large deals remain elusive in the aerospace and defense sector

With the exception of Boeing's acquisition of a facility previously owned by Vought Aircraft Industries, large deals in excess of \$1 billion continue to elude the A&D sector. Capital preservation and deleveraging by potential buyers, which restrained large activity in the first half of the year, remain significant factors in the third quarter, and will likely continue well into 2010.

Nonetheless, on a relative basis the third quarter witnessed an increase in deal size. The first quarter of 2009 experienced just one deal greater than \$50 million, and that deal barely crossed the threshold with a value of \$50.5 million. The second quarter was slightly better with four deals greater than \$50 million, two of which exceeded \$100 million. The third quarter saw another increase to six deals over \$50 million and was significantly better in terms of value with two relatively large deals of \$1 billion and \$565 million. If the

increase in both size and number of deals in the third quarter provides a hint to future deal activity, it is possible the first half of 2009 will represent the bottom of the mergers and acquisitions trough, down from the peak in 2007. As the economy improves, large deal activity should continue to increase since sector constituents have had time to focus on balance sheet deleveraging and cost reduction, potentially leaving them better positioned to resume external strategic actions. However, companies and investors remain cautious and, given the increase in mid-market deals, we believe that smaller, more strategically focused transactions will dominate the near-term landscape, as companies with the financial means will look to acquisitions, joint ventures, and partnerships to improve their existing businesses and allow them access to additional markets to support overall growth.

Multiples continue to look attractive

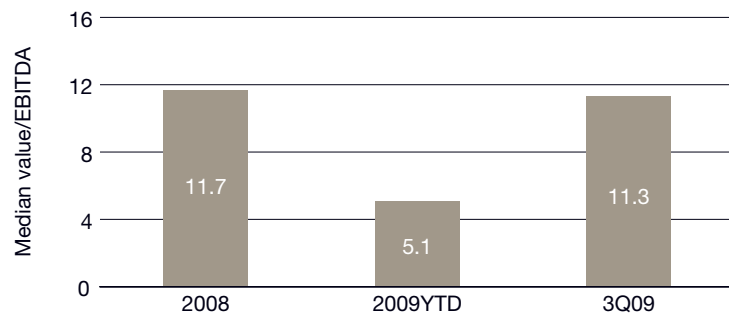
Year-to-date, the median deal value to EBITDA multiple for deals greater than \$50 million was 5.1 times versus 11.7 times (a 56 percent discount) in 2008. While the third quarter appears to show a swing back to 2008 levels, it must be noted that of the six deals in the quarter greater than \$50 million, only one deal supplied data on median deal value to EBITDA.

Considering the median deal value to sales multiple, which measures the amount buyers paid for each dollar of sales, valuations continue to be lower than previous periods, potentially indicating that valuations are returning to levels that are more reasonable than the inflated levels of the acquisition peak in 2007. Year-to-date, the median deal value to sales for deals greater than \$50 million was 0.8 times, reflecting a 47 percent discount to the deal multiples of deals announced in 2008 (1.5 times). Similar to the median value to EBITDA, the median value to sales metric of 5.1 times for the third quarter is the result of one deal.

When considering all deals during the third quarter, the median value to EBITDA for the year-to-date period is 8.8 times, compared with 13.7 times for 2007 and 10.6 times for 2008. The lower multiples in 2009 may suggest that deal values are returning to more normalized levels (from peaks in 2007); however, it is still unclear whether current multiples are sustainable or will continue to decline.

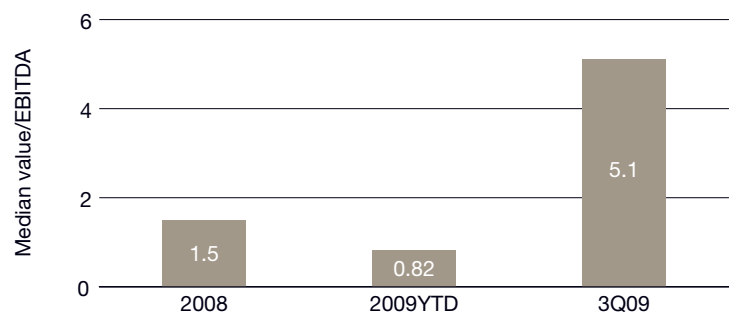
Deal valuation by median deal value to EBITDA

Median value to EBITDA for deals worth \$50 million or more



Deal valuation by median deal value to sales

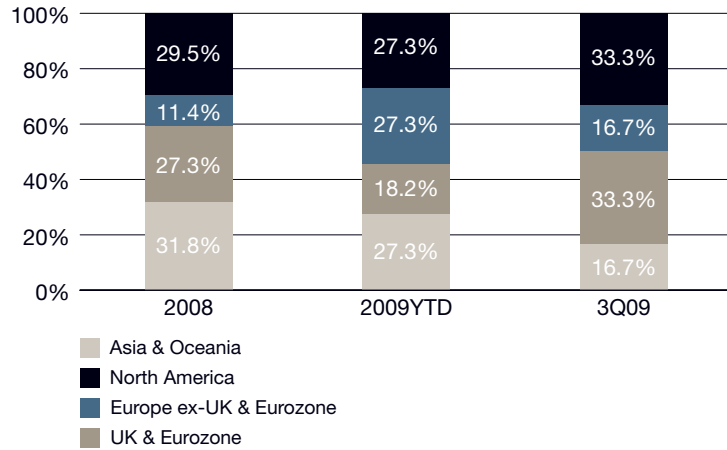
Median value to sales for deals worth less than \$50 million



Regional analysis

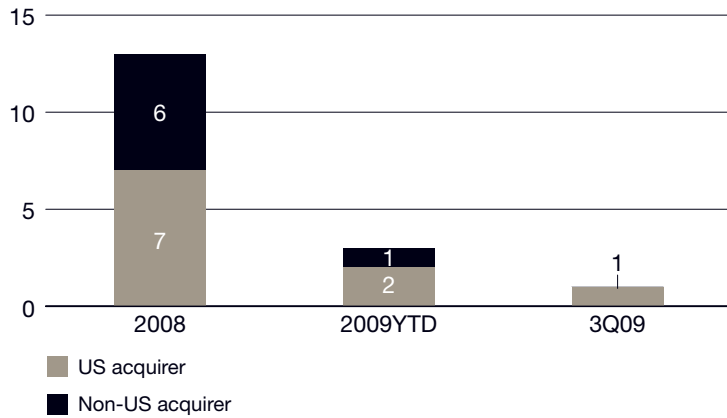
Regional distribution of deals by target region

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



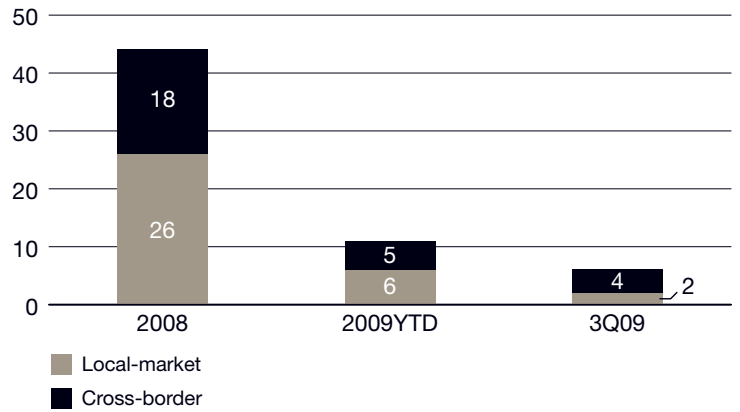
US vs. non-US acquirers of US targets

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

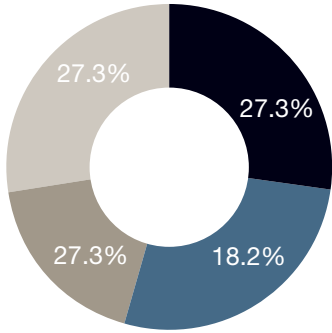


Local-market vs. cross-border deals (all nations)

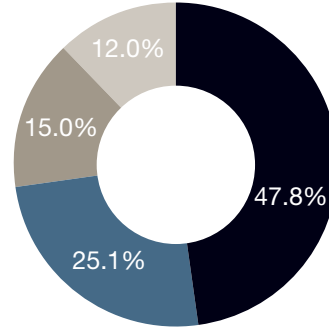
Measured by number of deals worth \$50 million or more



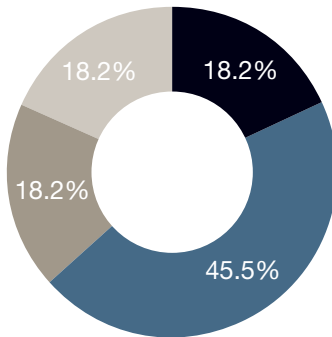
Regional distribution of deals by target region
 Measured by number of deals worth \$50 million or more (YTD09)



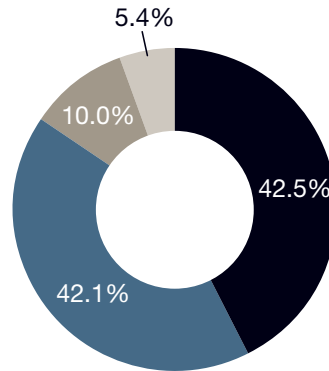
Regional distribution of deals by target region
 Measured by value of deals worth \$50 million or more (YTD09)



Regional distribution of deals by acquirer region
 Measured by number of deals worth \$50 million or more (YTD09)



Regional distribution of deals by acquirer region
 Measured by value of deals worth \$50 million or more (YTD09)



North America
 UK & Eurozone
 Asia & Oceania
 Europe ex-UK & Eurozone
 South America
 Africa/Undisclosed

North America and the UK and Eurozone play large role in current M&A market

When considering deals by target region, the number of deals splits evenly between Asia and Oceania, North America, and Europe (ex-UK and Eurozone) with 27.3 percent in each of these regions during the year to date. When considering deal value by region where the target resides, North America was dominant representing 48 percent of total deal value, which may suggest acquirers have been taking advantage of foreign currency movements, specifically the devaluation of the US dollar.

The North American and UK and Eurozone regions dominated acquirers by region, when measured by total deal value. This mainly reflects the two large deals announced during the quarter—Boeing’s acquisition of a Vought Aircraft Industries facility for approximately \$1 billion and BAE’s acquisition of the remaining 45 percent stake in BVT Surface Fleet for \$565 million.

While North America and the UK and Eurozone dominated deal value by acquirer, the number of deals during the third quarter and first three quarters of 2009 was skewed toward the UK and Eurozone, with the region accounting for 45.5 percent of the deals year-to-date. Unlike its heavy representation in total value of deals by acquirer, the North American region represented only 18 percent of the number of deals in the first three quarters of the year.

Of the six over \$50 million deals completed in the third quarter of 2009, four were driven by cross-market (cross-border) deals focused on ship building and repair (2), aircraft and parts (2), and SDNGA & NS, I&E (1). This cross-market deal focus may reflect buyers seeking greater geographic diversification while they continue to build scale in existing geographies. Interestingly, the two largest deals of the quarter, involving Boeing and BAE, were both local-market (within-border) deals. Local-market deals remain a negligible portion of the total number of deals, but represented 79 percent of the total deal value during the first three quarters 2009.

While North America and the UK and Eurozone represented the largest percentage of deal value by acquirer, the Asia and Oceania region may become a more active source of both acquirers and targets because of the region’s relatively high growth prospects, as key countries, including China and India, continue to see gross domestic product growth outpacing other regions of the world. The breakdown of local-market versus cross-border deals, regardless of nation, may indicate that acquirers are becoming more willing to assume the risks involved in growing their foreign market presence.

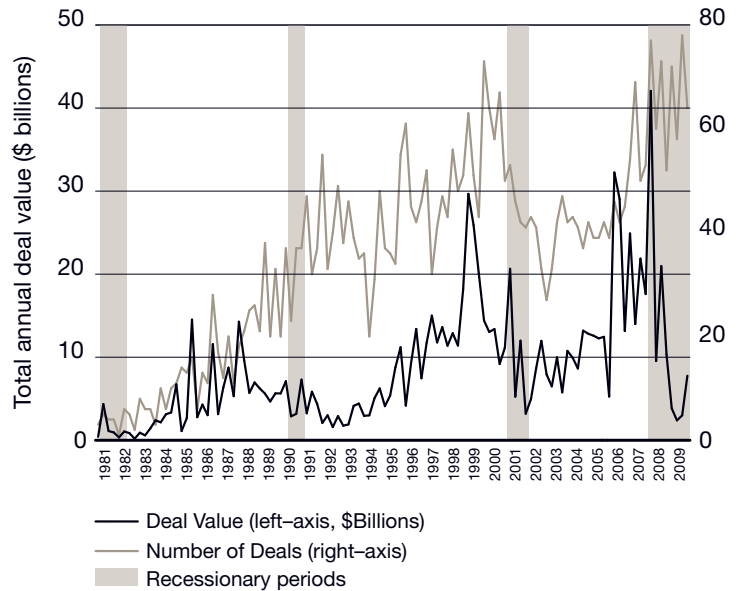
A look ahead

Does three quarters of sequential growth signal the bottom for aerospace and defense M&A activity?

Aerospace and defense M&A deal values have generally exhibited improvement when emerging from the three previous US recessions, even when deal activity recovers at a slower pace. In analyzing trends from the 2001 recession, it appears that M&A deal values bottomed at the end of the recession, while the number of deals continued to decline for roughly two years. Referencing the recessions of 1982 and 1991, deal values bottomed out roughly within one year of each recession, while the number of deals remained quite volatile with an upward-biased trend.

Taking into account deal activity after previous recessions, deal values might be at or near the bottom, given the quarter-over-quarter improvement experienced in the first three quarters of the year, which could potentially provide some comfort heading into 2010. As the recovery is expected to be a slow progression, it is difficult to assume M&A activity will follow a pattern similar to previous recessions. The depth and global scale of the current recession, the focus on the strengthening of balance sheets, and the significant degree of deleveraging, has forced some otherwise well-run companies to seek strategic niche acquisitions as a means to support overall growth in an environment where organic growth remains difficult.

Deal values may be reaching a more normal level following their year-over-year decrease, and it appears that “small and strategic” will remain the name of the game. Given these factors and considering third-quarter activity and positive economic signs, we are cautiously optimistic that M&A activity in the A&D sector will continue to grow over the next 12 to 18 months, with many deals arising from creative structures. Credit markets have started to ease for financially sound companies, which should help support larger deals in commercial aerospace and lead to additional consolidation and strategic initiatives. Defense, with its reliance on government spending, will likely remain under pressure as the defense budget could experience below-average growth as the government attempts to reduce record deficits via spending cuts.



Preparing your company to manage carbon as an asset

Although the United States has not yet passed comprehensive climate change legislation, 23 US states are either active in cap-and-trade systems or working to design them. Numerous bills have been introduced in Congress, with the most recent narrowly approved by the House of Representatives in June 2009.

Any system that places a monetary value on carbon requires companies to consider carbon management in corporate objectives and growth plans. Whether directly or indirectly affected by comprehensive climate-change regulation, organizations need to take practical steps to get ready. A good first step is to ensure internal financial teams understand the financial impacts of participation in cap-and-trade systems as part of setting a clear strategy that accounts for changes in climate laws and energy policy.

What are the required first steps to prepare for a GhG cap-and-trade system?

- It is imperative to know your carbon footprint. Companies that have not done so should identify the sources, types, and magnitude of GhG emissions they produce and compare them with those of their industry peers. As outlined in *The Greenhouse Gas Protocol*⁶, developing a measure of your carbon footprint includes addressing the following:
 - Setting organizational boundaries. This relates to determining what approach to take when accounting for emissions from joint ventures, subsidiaries, and other organizations.
 - Setting operational boundaries. Companies need to determine the scope of emissions they will include in their reporting. *The GhG Protocol* divides these into Scope 1 (direct emissions), Scope 2 (indirect emissions, such as from purchased electricity), and Scope 3 (other indirect emissions, accrued via employee travel, waste, contractor vehicles, product use, etc.).
 - Determining a base year for carbon footprint reporting. This includes determining the timing of when a company should recalculate its emissions due to business changes (e.g., acquisitions or divestitures, new calculation methodologies, etc.).
 - Identifying and calculating GhG emissions. This covers inventorying emissions sources, defining calculation methods and approaches, collecting data, selecting emissions factors, applying the calculation methods, and compiling the emissions data at the corporate level.
 - Addressing footprint quality. Companies should address issues such as quality/control and management review, and implementation of robust processes and controls for routine data collection and compilation.
- Companies should consider conducting an assessment that includes all direct and indirect carbon emissions to understand where the best opportunities to reduce emissions may lie, and to determine whether your role in carbon trading will be that of net buyer or seller.

Why is this issue so important?

Both climate change legislation and the adoption of International Financial Reporting Standards (IFRS) are looming. As North American companies either expand into countries where carbon is already regulated or are acquired by companies in those countries, we believe they must take action to compete successfully in a carbon-constrained world. They must recognize that environmental factors, accounting concerns, and broader issues regarding corporate responsibility can significantly influence the value of transactions. Buyers and sellers want to know the environmental, social, ethical, and economic risks related to their transactions that can affect operating costs, compliance, and financial reporting.

Our approach

PwC's Transaction Services group undertakes a systematic review of the risks and liabilities arising from a transaction, and assesses their financial reporting impacts. This includes risks related to operational environmental performance, legal compliance, reputation, and stakeholder pressures. PwC also provides ongoing support in transaction negotiations and in the development of systems to manage significant risks and liabilities. We advise companies on sustainability and climate change-related financial accounting and reporting issues as well.

⁶ World Resources Institute and World Business Council for Sustainable Development, *The Greenhouse Gas Protocol: A Corporate Accounting and Reporting Standard* (March 2004): www.ghgprotocol.org/files/ghgprotocol-revised.pdf.

Specialty case study

Client: Bombardier Inc.

Client issue	<p>After completing and issuing a corporate responsibility report, a large transportation and aerospace equipment manufacturer wanted to focus its efforts on reducing its carbon footprint—a priority identified in its report. Before moving forward with this effort, the company needed to determine its GhG emissions throughout its operations to be able to develop an informed reduction strategy.</p> <p>After working with PwC to complete its corporate responsibility report, the company requested the firm’s help to benchmark its carbon emissions and develop an attainable energy and carbon management strategy.</p>
Approach	<p>PwC assembled an advisory team to help the client calculate its global carbon inventory. To do so, the team:</p> <ul style="list-style-type: none">• Established with the client appropriate organizational and operational boundaries for each of the client’s separate businesses, which guided the collection and reporting of GhG emissions data used to develop a GhG emissions inventory report.• Developed and established data collection tools, including templates for recording information and detailed instructions to complete them.• Created a program manual that set out clear and consistent instructions for the client’s global operations and included key terms as well as parameters and definitions for data collection.• Identified and documented key conversion equations and quantification protocols used to translate energy consumption data into GhG emissions, which were also included in the program manual.• Assisted with the client’s adoption of an integrated data management system that would gather and report GhG emissions information throughout the client’s global operations. To achieve this, PwC collaborated with the client and its service provider to facilitate the transfer of the appropriate data, calculations, and reports into the new software system.• Calculated the client’s GhG emissions inventory from the energy consumption data gathered.• Benchmarked the client’s facilities to identify key areas of priority, and then advised the client on its adoption of an energy and carbon management strategy. <p>The team assisted the client with its establishment of an energy and carbon management strategy. The strategy focused on making operations more energy efficient, purchasing renewable energy where appropriate and available, and considering how carbon offsets may be able to assist further in reducing the client’s environmental impact.</p>
Impact	<p>The client now has a clear understanding of its current carbon footprint and a ranking of its operations, business units, and divisions to prioritize its GhG emission reductions effort. With this vital knowledge, the client was better equipped to develop goals and objectives and establish a robust energy and carbon management strategy to become more environmentally responsible. The client also has been able to establish benchmarks from which it can accurately measure the success of its reduction strategy.</p>

PricewaterhouseCoopers' aerospace and defense experience

Deep aerospace and defense experience

PwC's Aerospace and Defense practice is a global network of 1,200 partners and client service professionals who provide industry-focused assurance, tax, and advisory services to leading aerospace and defense companies around the world. This aerospace and defense experience is enhanced by that of 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 aerospace and defense companies address a 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 aerospace and defense 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 aerospace and defense organizations. PwC is a sponsor of leading industry conferences and frequently authors articles for, or is quoted in, leading industry publications. We are proud of our relationships with Aviation Week and Flight International as well our participation in industry conferences and associations, such as the Aerospace Industries Association (AIA) and American Conference Institute (ACI). Our involvement in these organizations

reflects our commitment to addressing industry needs and furthering industry dialogue with aerospace and defense industry leaders.

Quality deal professionals

PwC's Transaction Services practice, with more than 3,800 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 Aerospace and Defense 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

In addition to having more than 1,200 professionals who serve the aerospace and defense industry, our team is part of an extensive Industrial Products group that consists of 31,000 professionals, including approximately 15,800 providing assurance services, 9,000 providing tax services, and 6,200 providing advisory services. This expands our global footprint and enables us to concentrate efforts in bringing clients a greater depth of talent, resources, and know-how in the most effective and timely way.



Contacts

PricewaterhouseCoopers global Aerospace and Defense practice

PwC's Aerospace and Defense practice provides industry-focused assurance, tax, and advisory services. Through our global network, we can draw upon the in-depth industry experience of specialists in every country where your company operates. Our people can help you deal with the challenges of today, and they understand the 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 Financial and includes deals for which targets 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) ship building and repair; 4) guided missiles, space vehicles, and parts; 5) search, detection, navigation, guidance, aeronautical, and nautical systems, instruments, and equipment (SDNGA & 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 January 1, 2007, and June 30, 2009, 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, refers to transactions with a disclosed value of at least \$50 million unless otherwise noted.

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, and China, when referenced separately, includes Hong Kong.

NOTE: Boat building and repair is no longer included in our analysis.

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