

Missioncontrol

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First-quarter 2015 global aerospace and defense industry mergers and acquisitions analysis

To help provide insight into recent mergers and acquisitions (M&A), PwC is pleased to share *Mission control*, our quarterly analysis of M&A activity in the global aerospace and defense (A&D) industry.



Chuck Marx

Quarterly aerospace and defense deal activity

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

	2012				2013				2014				2015
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q
Number of deals	3	14	8	16	12	12	8	9	13	18	7	15	9
Total deal value (\$ bil.)	1.3	4.3	6.2	9.2	1.9	4.1	3.6	4.0	3.5	13.2	0.9	4.2	8.5
Average deal value (\$ bil.)	0.4	0.3	0.8	0.6	0.2	0.3	0.4	0.4	0.3	0.7	0.1	0.3	0.9

Source: Thomson Reuters/ PwC Analysis

The A&D sector got off to a strong start in 2015 with the announced acquisition of Exelis by Harris Corporation, both mid-tier suppliers of advanced military technology. At nearly \$5 billion, the megadeal is the largest transaction in the A&D sector since United Technologies' acquisition of Goodrich in 2011 and among the top five largest in the last ten years.

Among the motivations for the deal cited by the companies are gaining greater scale, more balanced earnings portfolio, and stronger platform for growth. Other motivations include cost efficiencies in manufacturing, supply chain, and other functional efficiencies. In addition, Exelis is a strong player in electronic warfare systems, a key priority area identified by the defense department, and the new joint entity aims to optimize their R&D portfolio to drive further innovation.

The Pentagon continues to maintain its strict stance on deals restrictions among defense primes to maintain the competition level and will scrutinize other lower-tier deals. We are cautiously optimistic that activity among smaller- and mid-tier suppliers will continue to drive transaction activity in the A&D sector.

In addition to the headline megadeal, divestitures and spin-offs remained popular in 1Q15, accounting for six of the nine deals in the quarter. The most common driver for the divestitures has been a desire to exit businesses directly impacted by decreased military spending. Companies in the A&D sector, as well as diversified industrials, are optimizing portfolios to focus on higher margin businesses aligned with higher growth markets. For example, in 1Q15, Dover sold its Sargent Aerospace & Defense unit, a manufacturer of precision-engineered components, to RBC Bearings for an estimated \$500 million. Similarly, TransDigm Group acquired Telair Cargo Group, a manufacturer of aircraft parts and auxiliary equipment, from AAR Corp. for \$725 million.

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

- **Supply chain pressure.** Increasing supply chain complexities and OEM pressure is spurring activity among mid- and lower-tier players across the supply chain. Alcoa announced it would acquire RTI International Metals, a leading titanium supplier to the A&D industry for \$1.5 billion. Alcoa also completed the acquisition of a privately held company, TITAL, a manufacturer of titanium and aluminum structural castings for aircraft engines and airframes. Please note that these metals industry deals are not included in our A&D industry totals. Three



small suppliers, Vector Industries, Polaris Machining, and Quality Manufacturing also merged to form a new, stronger consolidated entity, Integrated Aerospace Manufacturing LLC.

- **High-priority products and services.** Defense players continue to look for pockets of strategic growth areas particularly among intelligence, surveillance, and reconnaissance assets as well as electronic warfare. Science Applications International Corporation (SAIC) announced to acquire Scitor for \$790 million with a strategic intent to accelerate its move into the intelligence space. In another strategic deal, Raytheon acquired Sensintel, a company specializing in unmanned aerial systems.
- **Financial investors favor stability and niche capabilities.** Financial investors continue to invest in aerospace companies with the acquisition of high-quality assets with annuity-style revenue streams and diversified customer bases or niche capabilities. For example, Canada-based PE firm, Onex Corporation, acquired Survitec, a leading marine and A&D survival equipment provider, for \$680 million.
- **Keep an eye on MROs.** Driven by excess funds from low fuel prices and robust aircraft utilization rates, the fragmented commercial MRO market is likely to see an increase in business and transaction activity.
- **Surplus funds.** A&D companies continue to announce plans to return capital to shareholders through buybacks, supported by strong cash flows. Availability of cash and access to capital are not an impediment to deal flow.

The deal-making outlook for the A&D sector looks to improve on optimism regarding commercial aerospace, including rising demand for business jet and aftermarket services, even as high valuations and an uncertain budget outlook have restrained M&A deals in the sector. As shared in recent reports, M&A valuations have helped drive a high rate of divestitures among defense companies. At the same time, some executives have specifically cited valuations as a source of concern when considering whether their companies can create value from potential acquisitions.

Launch the data explorer at www.pwc.com/us/missioncontrol for a deeper dive into the data, or contact us to further discuss our insights.

Sincerely,



Chuck Marx
US Aerospace & Defense leader