Mission control

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Third-quarter 2014 global aerospace and defense industry mergers and acquisitions analysis

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Welcome to *Mission control*, our quarterly analysis of mergers and acquisitions (M&A) in the global aerospace and defense (A&D) sector.

The third quarter was one of the weakest quarters for deal volume and value in recent years. However, thanks to more robust M&A activity during the first half of the year, 2014 is still on pace to exceed 2013 deal totals.

Quarterly aerospace and defense deal activity
Measured by number and value of deals worth $50 million or more

	2011	2012				2013				2014		
	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q
Number of deals	11	3	14	8	16	12	12	8	8	13	15	6
Total deal value ($ bil.)	3.4	1.3	4.3	6.2	9.2	1.9	4.1	3.6	3.8	3.5	10.9	0.8
Average deal value ($ bil.)	0.3	0.4	0.3	0.8	0.6	0.2	0.3	0.4	0.5	0.3	0.7	0.1

Source: Thomson Reuters/ PwC Analysis

Divestitures and spin-offs remain very popular among aerospace and defense companies, with the volume of these types of deals on pace to hit a record high for 2014.

The most common driver for the divestitures has been a desire to exit businesses that have been directly impacted by decreased military spending, including units that produce vehicles, electronics, and communications. Companies have designed several noteworthy spin-offs to create more focused business portfolios, as well as clear a path for future acquisitions. Another driver has been the efforts of some aerospace and defense companies to offload some of their small industrial units.

PwC analysts are monitoring several other trends that are expected to affect the values and locations of deals in the aerospace and defense sector, including:

- Clearer defense demand – The Bipartisan Budget Act of 2013 has helped to clarify overall defense demand, thus contributing to a better deal environment. However, competition for major weapons programs could provide additional M&A catalysts. Depending on the decisions made on these programs, some contractors could seek acquisitions to improve their supply chain capabilities. In contrast, some of the unsuccessful contractors may simply decide to exit these categories. There are good reasons for increased transnational defense deals, particularly in Europe, to offset spending weakness while retaining industrial capabilities. Yet it is also clear that these deals can face significant political challenges.

- Aerospace aloft – Matching the overall sector trend, aerospace deal announcements were weaker in the third quarter than in recent quarters. However, aerospace targets still represent the largest segment of the market. Aerospace should continue to lead the market as higher commercial aircraft production rates make vertical integration of the supply chain more attractive from a return standpoint.

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- MRO maintains traction – The highly fragmented MRO industry is also an attractive area for consolidation. MRO deals can help competitors increase capabilities across the global fleet, expand geographically, and reduce costs. Because many of these deals involve small and/or unlisted targets with undisclosed deal values, they are unlikely to grab headlines to the same extent as other aerospace and defense M&A.

- Leveraging cash and short term investments – Although there has been a general upward trend in the amount of cash and short term investments held on the balance sheets of leading A&D companies, most have remained cautious about making acquisitions because the direction of future spending remains uncertain. Many are actively evaluating their portfolios, and will invest to remain competitive with non-traditional players. The DoD is increasingly relying on the latter as rising program costs and greater technical complexity have led to the arrival of new entrants that can fulfill mission needs with less sophisticated, more affordable, innovative systems derived from commercial investments.

- Unmanned deals – Militaries have increased funding for UAVs as roles for these aircraft expand, and commercial market opportunities are also significant. This growth could attract more interest in acquisitions of small UAV companies.

As shared in recent reports, M&A valuations remain robust across the sector. These high valuations, as well as investor pressures in some cases, 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. Lofty valuations are expected to continue the bias in favor of trying to sell or spin off assets as opposed to retaining them, a factor that will tend to restrain overall deal totals as we enter the final quarter of 2014.

We're pleased to present our third-quarter 2014 analysis as part of our ongoing commitment to providing you with a deeper understanding of M&A trends and prospects in the industry.

Launch the data explorer at http://www.pwc.com/us/en/industrial-products/publications/mission-control.jhtml for a deeper dive into the data, or contact us to discuss our insights.

Sincerely,

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