

# Aerospace & Defense

Spring 2010

## M&A Review and Outlook

Merger and Acquisition (M&A) activity in the aerospace and defense industry was expectedly subdued in 2009 compared with previous years. Globally, 157 deals with an average transaction size of US\$158 million were closed in 2009 versus 176 deals with an average transaction value of US\$272.2 million in 2008.<sup>1</sup> Of the deals completed in 2009, only 23 were greater than US\$100 million, down from 27 in 2008, which is the lowest number of deals since 2003. Of the 23 deals in the US\$100 million plus category, the average transaction value declined 11 percent from last year to US\$483 million, the lowest since 2004. M&A activity picked up slightly among U.S. buyers after a quiet 2008. Approximately 61 percent of global deals by volume and equally 61 percent of global deals by value were completed by U.S. buyers compared to 41 percent and 38 percent, respectively, in 2008. However, since 1999, U.S. buyers had

never accounted for less than 65 percent of global deal volume and 47 percent of global deal value before 2008.<sup>2</sup>

A total of 14 transactions with a value greater than US\$100 million were closed by U.S. acquirers, an increase from 11 in 2008 but a decline from 42 during 2007. The average transaction size fell 5 percent to US\$486 million, which is the first time the average dipped under US\$500 million since 2004. Looking over a longer time frame, with the exception of 2008, the number of deals with U.S. acquirers valued at more than US\$100 million was the lowest since 1999.<sup>2</sup>

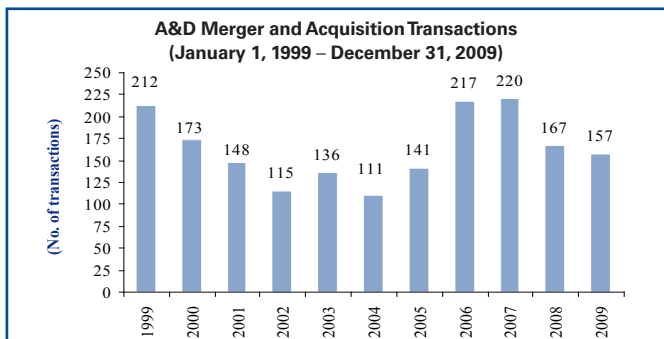
Once again, the large cap aerospace and defense companies were involved in a few sizable M&A deals. Boeing, General Dynamics, and Raytheon each completed one deal last year. Boeing acquired Vought Aircraft Industries' Charleston, South Carolina facility for approximately US\$1 billion (including US\$580 million in cash and US\$442 million in released

financial obligations by Boeing) and will use the facility as a second assembly line for the 787. Many observers view this transaction as a tactical move to maintain the highly anticipated 787 program schedule. General Dynamics acquired Axsys Technologies for US\$643 million and Raytheon bought BBN Technologies for US\$350 million. United Technologies also announced a deal to acquire GE's security business for US\$1.8 billion; the transaction closed in March 2010.<sup>2</sup>

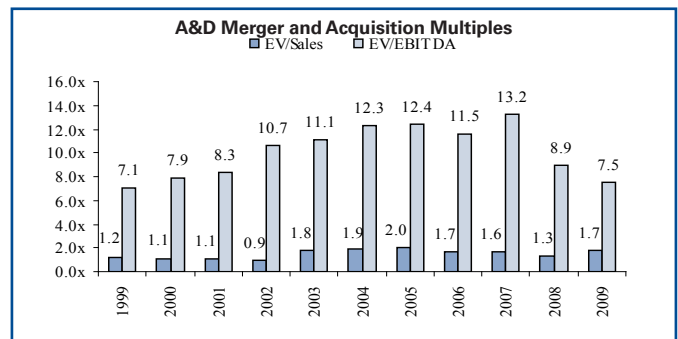
While the large caps did not complete many acquisitions last year, they were active in divestitures. The biggest U.S. aerospace and defense transaction in 2009 was KKR and General Atlantic's purchase of Northrop Grumman's TASC Advisory business for US\$1.65 billion. Northrop said the company decided to divest the division due to the government's tougher stance regarding organization conflicts of interest, and

<sup>1</sup> Thomson Reuters, December 31, 2009.

<sup>2</sup> JP Morgan, Aerospace and Defense Industry Report, January 6, 2010.



Source: Capital IQ, December 31, 2009



Source: Capital IQ, December 31, 2009

it is possible that the new rules could result in other transactions as well. The TASC transaction is the second major transaction in two years involving a private equity firm acquiring a defense services company—the Carlyle Group acquired Booz Allen’s government advisory business for US\$2.5 billion in 2008.<sup>2</sup>

According to industry analysts, there are three primary reasons for lackluster M&A activity in 2009. First, the persistence of the financial crisis in the early part of the year encouraged executive management teams to shy away from major cash expenditures and focus on cost-cutting and cash conservation measures. Furthermore, the potential for additional cash pension contributions from continued investment losses continued to loom over corporations. Today, M&A activity appears to be less constrained as most large cap companies have built strong balance sheets and have a realistic option of accessing the capital markets. As the market settles, the boards and management teams of corporations seem to be shifting focus back to growth.

Secondly, analysts believe the U.S. Department of Defense (DoD) opposes further large-scale consolidations of defense companies. Consolidation among the major industry leaders may impede innovation and cause pricing concerns. Consequently, the industry may expect few announcements of large deals and consolidation between the leaders appears unlikely.

Lastly, it takes a willing seller to make a deal, and despite the market turmoil of the past 18 months, it is unclear that targets were willing to sell at reduced

valuations sought by acquirers. The stock market rebound that began in March 2009 likely reinforced targets’ desire to hold out longer.

Looking forward, it is challenging to predict M&A activity in 2010. One popular position is that the industry will likely use M&A as a means to increase or maintain market share in the midst of an improving economy, developing international markets, and changing defense priorities. The U.S. DoD budget is changing in strategy and funding, and will benefit firms such as unmanned aircraft system manufacturers and cyber security companies. Analysts project M&A activity in 2010 to start slow, but to accelerate throughout the year, leading to a robust and active market for transactions in 2011.<sup>2</sup>

### 2010 Industry Outlook

The momentum of the aerospace and defense industry generated by the long period of growth and expansion during the prior decade was critical to the overall strength and resilience of its industry participants throughout 2009. The Aviation Industries Association (AIA) projects that the momentum will push commercial aerospace sales to a record year in 2009 despite the overall economic challenges. AIA estimates that aerospace sales reached US\$214.1 billion in 2009, up more than 4 percent from 2008.

Looking ahead, the aerospace industry will likely continue to endure economic resistance before finally breaking through to clearer skies. The industry should likely continue to recover along with the overall economy. There are already indications of stabilization evidenced by key aerospace matrices.

Boeing recently reported that fewer customers were deferring jet orders.<sup>3</sup> Additionally, the International Air Transport Association (IATA) is forecasting international passenger traffic to grow by 4.5 percent in 2010 from a year ago. This forecast was increased from the previous September 2009 forecast of 3.2 percent annual growth, and follows an estimated contraction of 4.1 percent for 2009. In particular, significant growth is anticipated to come from emerging aviation markets such as China, India, and the Middle East.<sup>3</sup>

On the defense side, the launch of the Joint Strike Fighter is expected to partially offset the potential impact of a few existing aircraft program reductions or cancellations. Additionally, sales of unmanned aircraft systems are likely to boost defense sales. Demand for unmanned systems by the U.S. military has increased more than 600 percent since 2004, and is forecasted to double again between 2010 and 2015.<sup>4</sup>

### Conclusion

It is well known that aerospace and defense is a cyclical industry. Overall, the recent years have been very prosperous for the industry, evidenced by the first simultaneous civil and military aerospace upturn in 25 years. While a number of factors will impact the industry in the near future, the launch of the 787 and new defense priorities may be the key growth drivers for the industry going forward.<sup>4</sup>

<sup>2</sup> JP Morgan, *Aerospace and Defense Industry Report*, January 6, 2010.

<sup>3</sup> Aviation Industries Association, “2009 Year End Review and 2010 Forecast,” December 2009.

<sup>4</sup> International Air Transport Association, January 2010.

## Top Ten Global Deals by Transaction Value in 2009 (US\$ in Millions)

Close Date	Target	Buyer	Deal Size	EV/EBITDA	EV/EBITDA
MAY-09	Thales S.A.	Dassault Aviation S.A.	\$1,982.6	0.6x	5.3x
DEC-09	TASC, Inc.	General Atlantic LLC, KKR	\$1,650.0	1.0x	NA
JUL-09	Vought Aircraft Industries Inc. (SC assets)	Boeing Co.	\$1,002.7	NA	NA
AUG-09	Carlton Forge Works	Precision Castparts Corp.	\$850.0	NA	NA
SEP-09	Axsys Technologies, Inc.	General Dynamics	\$640.1	2.4x	12.6x
JUN-09	Wyle	Court Square Capital Partners	\$600.0	NA	NA
OCT-09	BVT Surface Fleet Ltd.	BAE Systems plc	\$487.0	1.5x	NA
APR-09	Woodward HRT, Inc.	Woodward Governor Co.	\$377.7	1.5x	11.7x
DEC-09	Atlantic Inertial Systems, Inc.	Goodrich Corp.	\$375.0	NA	NA
JAN-09	Airbus Filtron Limited	GKN Aerospace Services	\$243.8	NA	NA

Source: Capital IQ, December 31, 2009

## Market Snapshot

Company	Market Cap <sup>1,4</sup>	Share Price <sup>1</sup>	52 Wk Low	52 Wk High	1 Mo Price % Change	1 Yr Price % Change	Debt to TC	Price to BV	EV <sup>2</sup> /Sales	EV <sup>2</sup> /EBITDA <sup>3</sup>	
<b>S&amp;P 500</b>											
BOEING CO.	47,810.6	63.2	29.1	64.5	4.3%	101.3%	85.3%	23.8	0.7	14.0	
GENERAL DYNAMICS CORP.	27,984.3	72.6	35.3	73.1	8.5%	65.8%	23.7%	2.3	0.9	7.0	
GOODRICH CORP.	8,214.6	65.6	30.0	67.2	6.0%	98.2%	40.4%	3.1	1.4	7.9	
HONEYWELL INTERNATIONAL INC.	30,704.4	40.2	23.1	43.2	4.1%	50.0%	45.9%	3.7	1.2	8.2	
LOCKHEED MARTIN CORPORATION	29,193.3	77.8	57.4	87.1	4.4%	23.3%	55.0%	7.5	0.7	5.9	
NORTHROP GRUMMAN CORPORATION	18,547.8	61.3	33.8	62.2	8.3%	63.9%	25.3%	1.5	0.6	6.1	
RAYTHEON CO.	21,319.6	56.2	33.2	56.9	7.3%	40.5%	19.0%	2.2	0.8	6.3	
ROCKWELL COLLINS INC.	8,848.3	56.3	27.7	57.6	5.8%	80.4%	29.9%	6.9	2.1	9.4	
UNITED TECHNOLOGIES CORP.	64,352.5	68.7	37.4	72.9	1.8%	68.4%	31.3%	3.3	1.3	8.4	
<b>S&amp;P 500 Mean</b>					<b>5.6%</b>	<b>65.7%</b>	<b>40%</b>	<b>6.0</b>	<b>1.1</b>	<b>8.1</b>	
<b>S&amp;P 500 Median</b>					<b>5.8%</b>	<b>65.8%</b>	<b>31%</b>	<b>3.3</b>	<b>0.9</b>	<b>7.9</b>	
<b>OTHER PRIMES/SYSTEMS SUPPLIERS</b>											
BAE SYSTEMS PLC	20,132.6	5.7	4.5	6.1	0.0%	7.5%	41.1%	2.9	0.6	6.0	
BOMBARDIER, INC.	11,032.6	5.4	2.1	5.7	14.9%	134.8%	54.0%	2.9	0.6	7.2	
EUROPEAN AERONAUTIC DEFENCE AND SPACE	16,767.2	20.7	11.1	22.6	5.1%	40.8%	33.2%	1.0	0.2	2.5	
EMBRAER - EMPRESA BRASILEIRA DE AERONÁUTICA	3,972.9	22.0	9.3	25.3	3.8%	103.7%	40.9%	1.4	0.7	5.2	
FINMECCANICA SPA	7,473.5	13.0	11.4	17.5	-7.1%	1.6%	49.8%	0.9	0.6	5.7	
THALES	7,833.4	40.1	37.2	49.2	-12.1%	-1.0%	36.7%	1.5	0.5	9.7	
<b>Other Primes/Systems Suppliers Mean</b>					<b>0.8%</b>	<b>47.9%</b>	<b>43%</b>	<b>1.8</b>	<b>0.5</b>	<b>6.1</b>	
<b>Other Primes/Systems Suppliers Median</b>					<b>1.9%</b>	<b>24.2%</b>	<b>41%</b>	<b>1.5</b>	<b>0.6</b>	<b>5.9</b>	
<b>AVIONICS/ELECTRONICS</b>											
ALLIANT TECHSYSTEMS INC.	2,623.0	79.5	60.8	91.4	0.6%	12.4%	58.9%	2.8	0.8	5.6	
DRS DATA & RESEARCH SERVICES PLC	6.5	0.2	0.1	0.3	0.0%	0.0%	33.6%	0.9	0.2	NM	
HARRIS CORP.	5,915.0	45.2	26.1	49.7	5.4%	21.2%	37.8%	2.9	1.4	7.1	
HERLEY INDUSTRIES INC.	182.2	13.4	7.7	14.5	9.8%	38.1%	11.5%	1.2	1.1	10.3	
L-3 COMMUNICATIONS HOLDINGS INC.	10,566.9	91.4	57.1	92.1	9.7%	35.0%	38.2%	1.6	0.9	7.4	
CAE INC.	2,166.7	8.5	5.7	9.0	6.3%	63.5%	30.2%	2.1	1.6	6.8	
ULTRA ELECTRONICS HOLDINGS PLC	1,381.7	20.2	16.1	21.5	-1.0%	28.7%	27.8%	5.6	1.6	9.6	
<b>Avionics/Electronics Mean</b>					<b>4.4%</b>	<b>28.4%</b>	<b>34%</b>	<b>2.4</b>	<b>1.1</b>	<b>7.8</b>	
<b>Avionics/Electronics Median</b>					<b>5.4%</b>	<b>28.7%</b>	<b>34%</b>	<b>2.1</b>	<b>1.1</b>	<b>7.3</b>	
<b>COMPONENTS (LARGE CAP)</b>											
COBHAM PLC	4,220.7	3.7	2.5	3.9	0.0%	37.0%	45.1%	3.0	1.8	9.7	
CURTISS-WRIGHT CORP.	1,468.3	32.1	22.6	36.7	4.9%	20.7%	31.2%	1.5	1.0	7.4	
ESTERLINE TECHNOLOGIES CORP.	1,226.0	41.2	18.9	44.3	9.0%	62.8%	29.9%	1.1	1.1	6.6	
MEGGITT PLC	2,896.7	4.2	1.7	4.3	0.0%	133.3%	40.6%	1.6	2.3	8.9	
MOOG INC.	1,540.7	34.0	17.9	34.3	12.6%	86.9%	42.5%	1.5	1.2	9.2	
PRECISION CASTPARTS CORP.	15,974.2	112.8	47.7	118.6	7.1%	487.8%	4.8%	3.0	2.8	9.9	
ROLLS ROYCE GROUP PLC	15,762.8	8.5	3.8	8.5	10.4%	-57.9%	33.8%	2.8	0.9	7.1	
SMITHS GROUP PLC	6,175.9	15.8	9.8	16.3	-1.3%	-25.4%	53.1%	4.8	1.9	9.2	
TEXTRON INC.	5,430.6	19.9	3.6	23.5	2.1%	-10.3%	76.6%	2.1	1.2	15.6	
ZODIAC AEROSPACE SA	2,542.1	45.7	25.3	45.8	8.0%	50.3%	36.6%	1.4	1.0	9.0	
<b>Components (Large Cap) Mean</b>					<b>5.3%</b>	<b>78.5%</b>	<b>39%</b>	<b>2.3</b>	<b>1.5</b>	<b>9.3</b>	
<b>Components (Large Cap) Median</b>					<b>6.0%</b>	<b>43.7%</b>	<b>39%</b>	<b>1.9</b>	<b>1.2</b>	<b>9.1</b>	
<b>COMPONENTS (MID CAP)</b>											
DUCOMMUN INC.	182.8	17.5	10.9	21.4	-2.8%	37.8%	10.8%	0.9	0.4	4.5	
HEROUX-DEVTEK INC.	145.7	4.8	3.4	5.7	-2.0%	54.8%	28.5%	0.7	0.6	4.0	
MAGELLAN AEROSPACE CORP.	31.8	1.7	0.2	2.6	0.0%	325.0%	49.9%	0.1	0.4	3.9	
TRIUMPH GROUP, INC.	872.4	52.3	31.1	58.3	2.8%	44.9%	37.9%	1.2	1.0	6.2	
<b>Components (Mid Cap) Mean</b>					<b>-0.5%</b>	<b>115.6%</b>	<b>32%</b>	<b>0.7</b>	<b>0.6</b>	<b>4.7</b>	
<b>Components (Mid Cap) Median</b>					<b>-1.0%</b>	<b>49.9%</b>	<b>33%</b>	<b>0.8</b>	<b>0.5</b>	<b>4.3</b>	
<b>MRO/AFTERMARKET SERVICES</b>											
AAR CORP.	883.0	22.7	10.5	26.1	-2.2%	72.0%	30.8%	1.3	0.8	7.6	
HEICO CORP.	1,078.0	47.7	21.4	48.5	12.2%	95.5%	7.2%	3.1	2.2	10.9	
<b>MRO/Aftermarkets Services Mean</b>					<b>5.0%</b>	<b>83.7%</b>	<b>19%</b>	<b>2.2</b>	<b>1.5</b>	<b>9.3</b>	
<b>MRO/Aftermarkets Services Median</b>					<b>5.0%</b>	<b>83.7%</b>	<b>19%</b>	<b>2.2</b>	<b>1.5</b>	<b>9.3</b>	
<b>TOTAL AEROSPACE INDUSTRY MEAN</b>					<b>3.9%</b>	<b>65.6%</b>	<b>37%</b>	<b>3.0</b>	<b>1.1</b>	<b>7.7</b>	
<b>TOTAL AEROSPACE INDUSTRY MEDIAN</b>					<b>4.4%</b>	<b>47.4%</b>	<b>37%</b>	<b>2.1</b>	<b>1.0</b>	<b>7.4</b>	

1 Market Capitalization amounts are in millions, based on closing Share Prices as of February 28, 2010

2 Enterprise Value (EV) equals Market Capitalization plus Debt, Preferred Equity, and Minority Interest, minus Cash and Cash Equivalents

3 EBITDA equals Earnings before Interest, Taxes, Depreciation, and Amortization

4 Market Capitalization and Share Prices are based on foreign exchange listed securities and converted to US\$

Source: Capital IQ, February 28, 2010 and company filings

## Select Aerospace & Defense Transactions

- October 16, 2009 – **Raytheon Company** (NYSE: RTN), a provider of electronics, mission systems integration, and other capabilities in the areas of sensing, command, control, communications, and intelligence systems, acquired **BBNT Solutions, LLC**, a provider of technology solutions and services for government and business organizations, for US\$350 million.
- October 30, 2009 – **BAE Systems plc** (LSE: BA.), a provider of development, delivery, and support of defense and aerospace systems in the air, on land, and at sea worldwide, acquired **BVT Surface Fleet Limited**, a provider of surface warships and through-life support services, for US\$487 million.
- November 25, 2009 – **Chemring Group plc** (LSE:CHG), a manufacturer of energetic material products and decoy countermeasures for the defense, security, and safety markets worldwide, acquired **Hi-Shear Technology Corporation**, a manufacturer of pyrotechnic, mechanical, and electronic products primarily for the aerospace and national defense markets in the United States, for US\$132.3 million.
- December 18, 2009 – **General Atlantic, LLC** and **Kohlberg Kravis Roberts & Co.**, both private equity firms specializing in equity investments for acquisitions, leveraged buyouts, and management buyouts in large cap companies, acquired **TASC, Inc.**, a provider of information technology solutions for government and businesses internationally, for US\$1.65 billion.
- December 21, 2009 – **Goodrich Corp.** (NYSE: GR), a supplier of aerospace components, systems, and services worldwide, acquired **Atlantic Inertial Systems, Inc.**, a manufacturer of inertial products for navigation, guidance, and control, for US\$375 million.
- December 21, 2009 – **Curtiss-Wright Corp.** (NYSE: CW), a provider of precision components and systems and overhauling services, acquired **Skyquest Systems Limited**, a manufacturer of aircraft video displays, recorders, and video/radar converters for surveillance aircraft applications, for US\$16.1 million.
- January 9, 2010 – **AgustaWestland S.p.A.**, a manufacturer of helicopter systems for commercial and military customers, acquired **PZL-Swidnik S.A.**, a manufacturer of helicopters and passenger and military aircraft for the aerospace industry in Western Europe and the United States, for US\$111.5 million.
- February 16, 2010 – **Reims Aviation Industries SAS** (ENXTPA: ALRAI), a manufacturer of commercial and military aircraft worldwide, acquired **GECI International**, a technology engineering company offering consultancy and development services to the transportation sector primarily in France, for US\$111.2 million.
- February 17, 2010 – **Vought Defense Systems Corp.** (OTCPK: VDSC), a manufacturer of unmanned aerial vehicles, acquired **RedTide Defense Group, Inc.**, a manufacturer of unmanned aerial vehicles that provide aerial surveillance solutions for the defense industry, for an undisclosed amount.

Source: Capital IQ, February 28, 2010

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