Missioncontrol

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

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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.

Quarterly aerospace and defense deal activity

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

	2012			2013				2014				2015	
	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q
Number of deals	14	8	16	12	12	8	9	13	18	7	15	8	11
Total deal value ($ bil.)	4.3	6.2	9.2	1.9	4.1	3.6	4.0	3.5	13.2	0.9	4.2	8.5	3.9
Average deal value ($ bil.)	0.3	0.8	0.6	0.2	0.3	0.4	0.4	0.3	0.7	0.1	0.3	1.1	0.4

Source: Thomson Reuters/PwC Analysis

Overview

The A&D industry had modest headline results in 2Q15 with a drop in total deal value relative to the prior quarter. Of course, the bigger news took place after the quarter close, with Lockheed Martin's announced acquisition of the Sikorsky helicopter unit from United Technologies. The deal, valued at $9 billion, is the largest transaction in the A&D sector since United Technologies' acquisition of Goodrich in 2011, and second only to Martin Marietta in terms of deal size for the company.

With $3.9 billion in announced deals, 2Q15 totals were well below the $8.5 billion total deal value captured in the prior quarter and sharply below the same quarter of the prior year (which included five megadeals). The number of transactions of $50 million or above increased to 11, slightly below the five-year quarterly average. However, the annual run rate is slightly above the prior year and the ten-year rolling average. With Lockheed's acquisition of Sikorsky, that brings 2015's total to $21.4 billion, approximately equal with all of 2014's deal value of $21.8 billion.

M&A Themes

A&D companies are actively splitting public sector and commercial units and divesting lower margin businesses, such as IT services. The primes are consolidating or broadening leading positions in segments, allowing for focus on platforms. As outlined in our 2015 M&A outlook piece, restructuring, divestitures, and spin-offs also remain popular among A&D companies and diversified industrials. Companies are optimizing portfolios to simplify operating models, align with core capabilities, or to enter faster growing markets.

Commercial market exposure and specialty technology are among the two highest priority themes driving deal activity among defense contractors. High-growth markets, including cybersecurity, electronic warfare, and UAVs continue to see strong deal activity.

The cybersecurity market requires low capital investment, and often times results in attractive returns across a diversified customer base. Cyber-related vulnerabilities continue to surge with increasing adoption of cloud-, mobile-, and IoT-based applications. In a $1.9 billion deal, Raytheon Cyber Products (a business unit of Raytheon) merged with Websense, while other major tier 2 companies are looking to further develop and integrate cyber into major signal and data control offerings. Commercial businesses have different risk profiles and sales processes than traditional defense offerings. However, the opportunity remains highly attractive given the threat of cyberattacks to consumer and industrial businesses.

In electronic warfare, major players are realigning capabilities, business units, and looking to make acquisitions to continue the trend toward mission convergence, the integration of the core elements of electronic warfare and ISR (intelligence, surveillance, and reconnaissance) into a common, integrated technology and platform.

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

- **Activist investors.** Expect investment to increase as activists set their sights on larger targets that are rich in cash, but sitting astride portfolios with poor, or at least inconsistent, intrinsic and warranted value.

- **Surplus funds.** Many companies have increased stock repurchase programs to support share price, perhaps at the expense of strategic investment. R&D investments have been notable in areas such as 3D printing, cybersecurity, and fuel efficiency initiatives.

- **Keeping 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. Equipped with advanced big data and predictive maintenance capabilities, MRO companies are looking to leverage advances in technology to gradually enter into longer-term servicing contracts.

- **Space exploration.** Space exploration companies have attracted some attention from investors as valuations for companies with space exposure have improvement significantly.

Outlook

The deal-making outlook for the A&D sector looks to improve on optimism regarding commercial aerospace, as well as more aggressive portfolio management activity by defense contractors. High valuations and an uncertain budget outlook have prompted companies to reconsider their long-term growth potential and actively manage their business portfolios. This has led to a high rate of divestitures among defense companies and strategic acquisitions in high-growth, specialty areas with diversified revenue sources. We expect transaction activity to proceed at a healthy pace in both the commercial aerospace and defense segments of the sector.

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,

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