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DEAL TOTALS DIP IN 2020, BUT AEROSPACE M&A IS READY TO TAKE OFF AGAIN

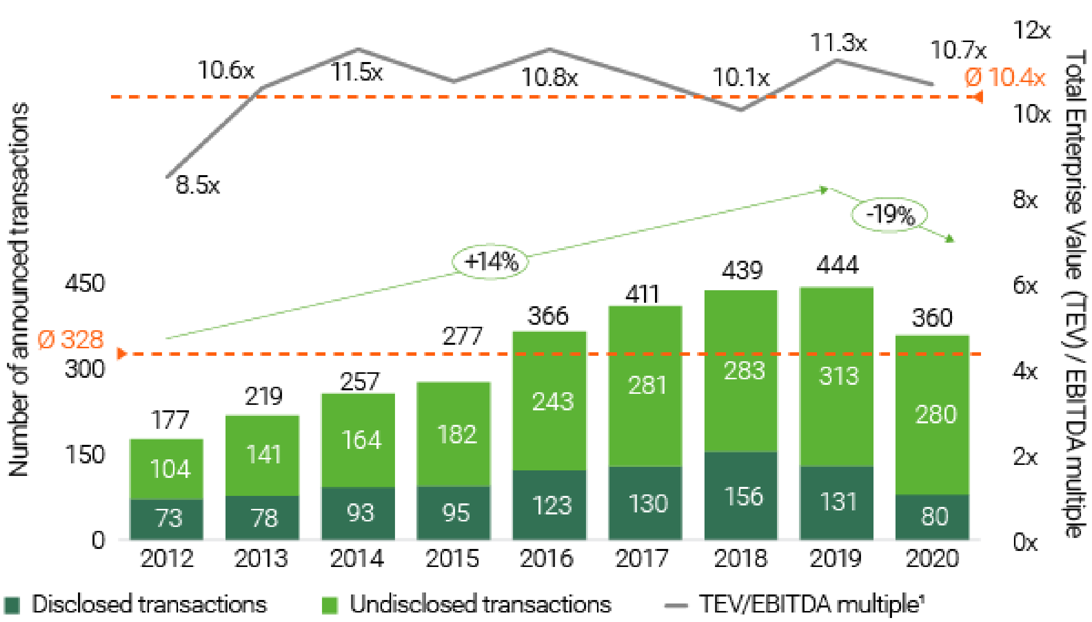
The AlixPartners A&D Minute

The pandemic's enormous brunt on commercial aviation included putting a sudden end to the eight-year record run of mergers and acquisitions action in the overall industry. Aerospace and defense M&A activity had reached new heights in 2019, continuing a multiyear trend and fueled in total deal value by the massive merger between Raytheon and United Technologies.

But the sudden halt in nearly all commercial air travel demand at the end of the first quarter of 2020 and the eventual instability in near-term forecasting led to a year of some notable deal cancelations, fewer transactions, and lower multiples. M&A activity had been increasing steadily for an aggregate 14% percent growth in deal count between 2012 and 2019. The drop in deal count in 2020 from 2019 alone came in at around 20% (Figure 1). The magnitude of the impact was especially prominent in the total enterprise value of deals, which dropped 77% between 2019 and 2020. This resulted in an average deal size decrease of 63% year-over-year.

FIGURE 1: 2020 ENDED THE EIGHT-YEAR GROWTH TREND IN DEAL COUNT

Announced A&D M&A transactions: 2012 to 2020



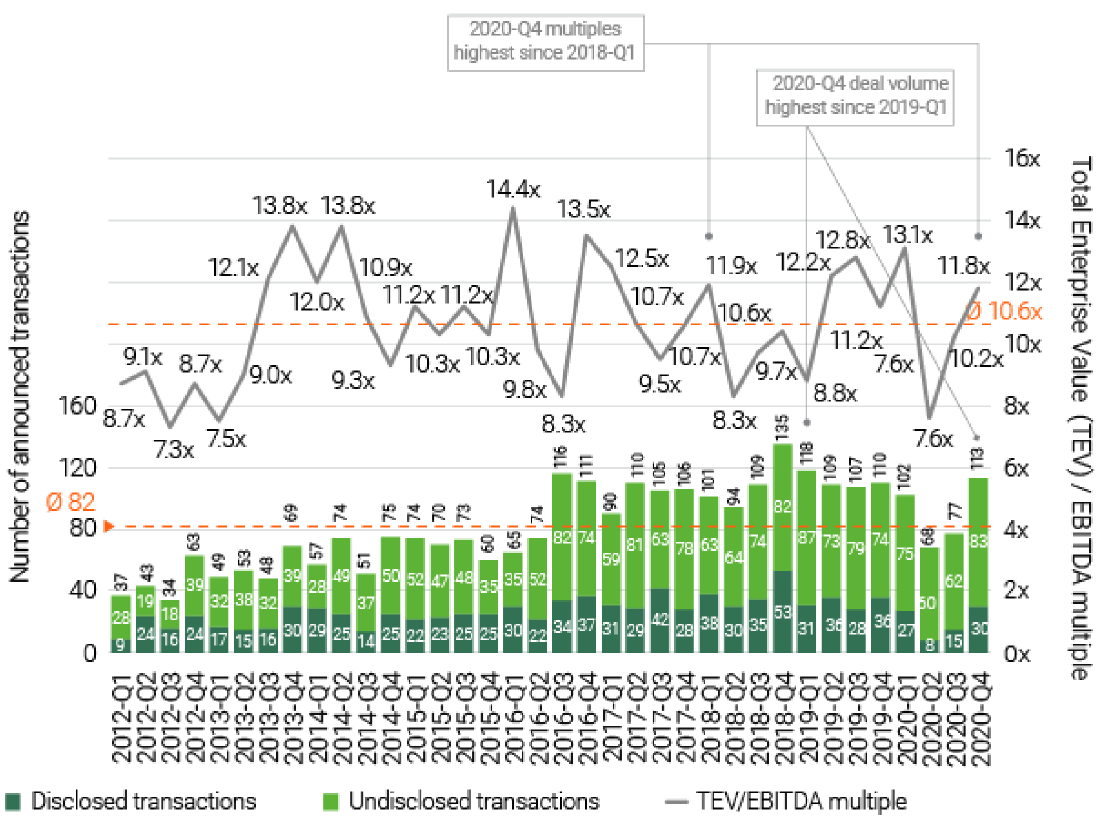
1. Average of quarterly multiples

Source: Capital IQ; company presentations; DACIS; Janes Capital Partners; AlixPartners analysis

The major disruptive factor was the massive decline in commercial air travel. By the second quarter, companies across the value chain had shifted focus to immediate cash management and rapid cost reduction. The sustained demand drop, combined with general uncertainty around the speed and magnitude of recovery, caused investors to hold capital instead of seeing this as an immediate buying opportunity. As a result, several transactions were paused or scrapped altogether as the dramatic change in market conditions made existing business plans obsolete and rendered prior valuation multiples irrelevant. These included, among others, the Woodward-Hexcel all-stock merger that was announced in January of last year and abandoned in April and Spirit AeroSystems' planned acquisition of Asco that was terminated in September 2020.

However, despite the substantive midyear dip, both deal volume and multiples saw sharp increases in the fourth quarter of 2020 (Figure 2).

FIGURE 2: ANNOUNCED A&D M&A TRANSACTIONS FROM 2012 TO 2020

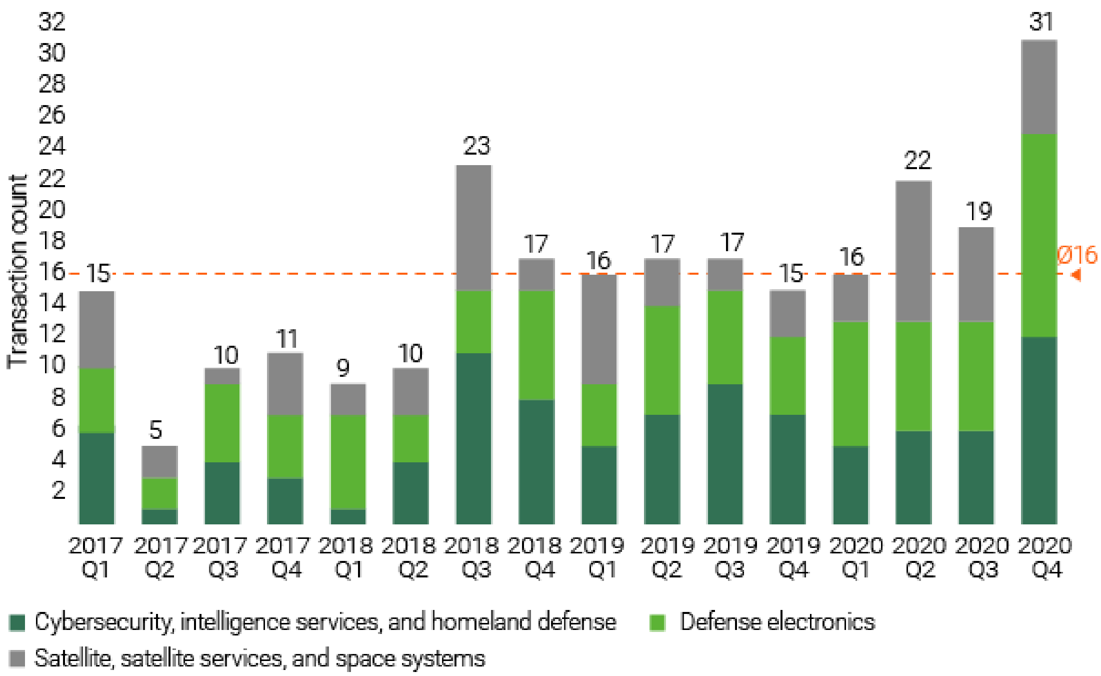


Source: Capital IQ; company presentations; DACIS; Janes Capital Partners; AlixPartners analysis

Targets with significant business exposure to government funding or other state support had the quickest and largest M&A activity upswing (Figure 3). Five of the top six announced deals in 2020, by valuation, came in defense or government demand-driven segments (Figure 4). Consistent with past years, private equity remains a considerable force and was involved in 60% of the top ten deals in 2020.

FIGURE 3: QUARTERLY TRANSACTION COUNTS IN 2020 FOR SELECT A&D SEGMENTS

(n = 253)



Source: Capital IQ; company presentations; DACIS; Janes Capital Partners; AlixPartners analysis

FIGURE 4: ALIXPARTNERS' TOP 10 A&D M&A DEALS ANNOUNCED IN 2020

RANK	ACQUIRER	SELLER	TARGET	IMPLIED TEV ($B)	TEV/ EBITDA
1	Lockheed Martin	Public	Aerojet Rocketdyne	5.1	14.1x
2	**Peraton (Veritas)**	Northrop Grumman	Fed. IT & Mission Support Services	3.4	N/A
3	BAE Systems	Raytheon	Military GPS business	1.9	15.2x
4	Stanley Black & Decker	**Tinicum**	Consolidated Aerospace MFG	1.5	16.3x
5	**Amentum**	**Cerberus**	DynCorp	1.3	7.7x
6	Science Applications	Unisys	Federal Business	1.2	13.0x
7	**Bain Capital**	Public	Virgin Australia	1.1	N/A
8	**Francisco Partners**	Raytheon	Forcepoint	1.1	N/A
9	Leidos	L3Harris	Security & Detection Systems	1.0	13.3x
10	TransDigm	**Advent International**	Cobham Aero Connectivity	1.0	N/A
				18.6 (total)	**13.1x (w. avg)**

	PRIMARY ACTIVITY	DEFENSE & GOV'T	CARVE OUT
1	Rocket and missile propulsion manufacturer	✔	
2	Cybersecurity, data analytics, cloud, mission critical app development, adv. engineering	✔	✔
3	Advanced, hardened and secure GPS products, including Manti-jamming, and anti-spoofing	✔	✔
4	Complex components & assembled products		
5	Aviation, logistics, training,intelligence and operational solutions	✔	
6	Infrastructure modernization,cloud migration, enterprise ITas-a-service, managed services	✔	✔
7	Commercial airline		
8	Cybersecurity		✔
9	Airport security and automation		✔
10	Highly engineered antennas and radios	✔	✔

Note: Private Equity (including portfolio companies) shown in **bold**

Sources: Capital IQ; company presentations; DACIS; Janes Capital Partners; AlixPartners analysis

The increased defense activity has two core drivers. First, strategic and private equity acquirers are showing continued interest in emerging defense technologies. Examples include Raytheon Technologies' acquisition of Blue Canyon, Lockheed Martin's purchase of Aerojet Rocketdyne, and increased activity in core C4ISR, missile, and cyber technologies. Hypersonic systems have also shown potential for growth, including a $700 million U.S. Department of Defense investment in 2019. The second core driver is the divestiture of noncore businesses following recent large mergers. Newly formed Raytheon Technologies offloaded Forcepoint in October 2020 and L3Harris sold its military flight training business in March. While some carveout transactions are a regulatory requirement of the merger, others hold the potential for companies to strategically focus on more profitable core businesses. In Europe, defense companies are consolidating, partly to remain competitive with U.S. companies. The European Defense Fund, which finances new multistate collaborative projects, including last year's partnership between Naval Group and Fincantieri, has proposed spending 8 billion euros on such deals in its latest budget.

The SPAC liftoff

SPACs, or special purpose acquisition companies, were a notable catalyst for the larger market in 2020. Since Virgin Galactic went public through this mechanism in 2019, there has been a dramatic resurgence of and explosive growth in the trend, with at least 11 more A&D-related SPACs going public per our analysis. Globally, of the $292 billion raised by all public offerings in 2020, $74 billion came from SPAC deals.

SPACs are shells that trade on the public market with the primary goal of merging with a private company to take it public without the usual rigamarole of a traditional IPO. Because high-profile names, such as former Boeing CEO Dennis Muilenburg and L3 co-founder Bob LaPenta, can be associated with a SPAC, investors are happy to entrust money to the shell company. In A&D, the most attractive investments have been in emerging technologies, including Blade Urban Air Mobility going public at a $825 million valuation, Wheels Up agreeing to a $2 billion deal, and Lilium combining with Qell Acquisition Corp. to form a company worth $3.3 billion.

As long as private investors keep pumping in money, SPACs are expected to be a significant factor in M&A going forward. That said, the mania has cooled lately, with IPO prices stagnating and some companies failing to find attractive deals.

Outlook for 2021

While we do not anticipate a similar volume of mega deals as in 2018 and 2019, the expectation remains that there will be progressive recovery in deal-making this year. Investor interest in commercial M&A has already started picking up, but there is still uncertainty around the topline profile of potential targets as many companies are still struggling with the impact of the pandemic and the lack of a clear recovery timeline. We do expect increased proactive consolidation in several commercial segments such as aerostructures, MRO, and aviation services, including mergers between equals and cashless mergers; of sustained transaction activity in defense, equipment, systems, and electronics (e.g., the recent acquisition of FLIR by Teledyne); and of additional carveouts from large groups, such as Rolls-Royce's planned sale of its ITP Aero unit.

Financial sponsors have dry powder and will remain active and seek to invest in platforms. Consolidation within the value chain, in particular aerostructures and part suppliers, will accommodate both the difficult situation commercial aerospace companies find themselves in and the need for OEMs to preserve and transform their supply chain for an eventual recovery and rebound in commercial traffic.

FOR A DEEPER DISCUSSION ABOUT THE CHALLENGES AND SOLUTIONS ASSOCIATED WITH THIS TOPIC, CONTACT:

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ABOUT US

For nearly forty years, AlixPartners has helped businesses around the world respond quickly and decisively to their most critical challenges – circumstances as diverse as urgent performance improvement, accelerated transformation, complex restructuring and risk mitigation.

These are the moments when everything is on the line – a sudden shift in the market, an unexpected performance decline, a time-sensitive deal, a fork-in-the-road decision. But it's not what we do that makes a difference, it's how we do it.

Tackling situations when time is of the essence is part of our DNA – so we adopt an action-oriented approach at all times. We work in small, highly qualified teams with specific industry and functional expertise, and we operate at pace, moving quickly from analysis to implementation. We stand shoulder to shoulder with our clients until the job is done, and only measure our success in terms of the results we deliver.

Our approach enables us to help our clients confront and overcome truly future-defining challenges. We partner with you to make the right decisions and take the right actions. And we are right by your side. When it really matters.