

# AEROSPACE & DEFENSE M&A PULSE

SECOND QUARTER 2019



# Q2'19

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# A&D Coverage Team

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## SELECT PMCF AEROSPACE & DEFENSE TRANSACTIONS

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# What We're Discussing with Clients

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Three topics have been the focus of many discussions with our clients: The disruptive effects of advanced technologies and how companies can address this, developing and managing effective supply chain dynamics, and attracting and retaining talent in an ultra-competitive job market.

## Technology & Disruption

Rapidly evolving trends in technology are driving disruptive innovation and changes in the A&D industry. Companies are increasingly looking to gain a competitive advantage and cost control by applying artificial intelligence, robotics, sensor technology, and other developments in advanced and additive manufacturing.

The rapid pace of technology innovation is most disruptive to small and mid-sized companies that have fewer resources to fund R&D projects. In addition, the already critical issue of cybersecurity is becoming an even bigger priority. An appropriate level of investment and sound strategy for cybersecurity is imperative for companies to protect themselves and their IP.

Companies are finding ways to bridge this gap, however, through collaborations with other industry players and academia to stay ahead of the technological transformation. This has led to a deeper and more complex web of connectivity among companies, researchers, universities, and government agencies. Most states sponsor and fund associations or consortiums, such as the Aerospace Industry Association of Michigan and the Maryland Defense and Aerospace Consortium, which foster collaboration, networking, research, and funding between various entities. Congress and the Department of Defense are encouraging these types of groups to instill greater partnership between these groups. Rep. Anthony Brown stated "Much of the innovation takes place in small- and medium-sized firms, and when those firms can partner with larger companies then we are going to get to the warfighter, the equipment, the systems, the information, and the technology they need at a much quicker pace." Companies of all sizes, but particularly small-to-mid sized companies and suppliers with limited resources that are active in these consortiums will be better positioned as technology and innovation continue to evolve.

## Supply Chain Dynamics

The supply chain has always been a highly interconnected, global-scale aspect of the A&D industry, and central to every company's management and operational strategy. Reliable and efficient logistics and value-adding partners can make or break a company's competitive position.

Just as technology is revolutionizing products and manufacturing, it is driving companies across all stages of the supply chain to put increased emphasis on engaged processes and systems throughout the supply chain in design and engineering, quality, planning, procurement, manufacturing capacity, and delivery.

Prime and Tier 1 suppliers are increasingly relying on smaller players to handle lower value-added processes, which helps to simplify internal processes and cost structures. Focused suppliers with developed and differentiated competencies who can successfully manage newer and more complex supply networks by maintaining the necessary workforce talent and required internal capabilities can leverage these into a strong position as valued and coveted partners within the network.

## Recruiting and Retaining Talent

Demand for highly skilled workers in the ultra-competitive A&D labor market is intense, which makes establishing a competitive wage and benefits package a critical starting point for attracting and retaining top talent. Thus, a company should have an accurate picture of compensation in its market; trade and industry associations and local economic development organizations are good sources of relevant labor market data.

Keeping abreast of the competition in terms of wages and benefits is not by itself an effective labor retention strategy. Attracting and retaining talent can be done in more value-adding ways that make the business stand out from the competition, such as expanding family leave and vacation accrual policies, extending health insurance coverage, and upgrading 401(k) programs.

Tying skills to advancement and compensation also helps to build employee loyalty and maintain a growth-oriented career environment. In-house training programs can also be the basis of partnerships with local schools, helping to attract young workers as a pool of developable talent.

# Q2 2019 Market Summary & Outlook

## 2018 Aerospace & Defense M&A Market Dynamics

Overall M&A deal volume declined in 2018 after three successive years of growth, but is expected to remain robust in 2019 as multinational companies pursue a growth and centralization strategy by acquiring small and medium enterprises.

Strategic buyers will remain active buyers in 2019, as the shift toward advanced technologies and automation drive market focus and M&A activity. Multinationals in particular are focusing on consolidating supply chains to help build critical mass, realize manufacturing efficiencies, and grow competitiveness. Smaller suppliers that are able to differentiate themselves through value-added work and advanced processes will become attractive targets.

Transaction valuations have remained relatively steady over the past year. For A&D transactions under \$250 million, mean enterprise value to EBITDA multiples trended slightly higher from 8.4x to 8.7x between Q2 2018 and Q1 2019.

AEROSPACE AND DEFENSE DEALS BY YEAR



Source: Capital IQ

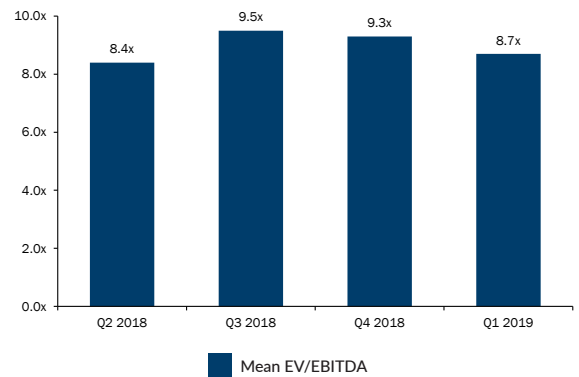
## PMCF Perspectives: Aerospace & Defense Plastics

Plastics represent one of the hottest growth components in the industry, with the global market for plastics in aerospace applications expected to grow by 40% over the next five to seven years. The US aerospace plastics market alone is expected to see compound annual growth rate of about 6%, climbing from \$295 million in 2018 to more than \$430 million by 2025.

M&A activity in the sector has been driven by the wider development and application of thermoplastic extrusions, and a trend towards weight- and fuel-saving design in commercial airliners and small military aircraft, replacing aluminum parts with fiber-reinforced plastics. Significant growth in applications has been in the increasing use of polymethyl methacrylate (PMMA) as a substitute for glass in cabin windows and cockpit windshields.

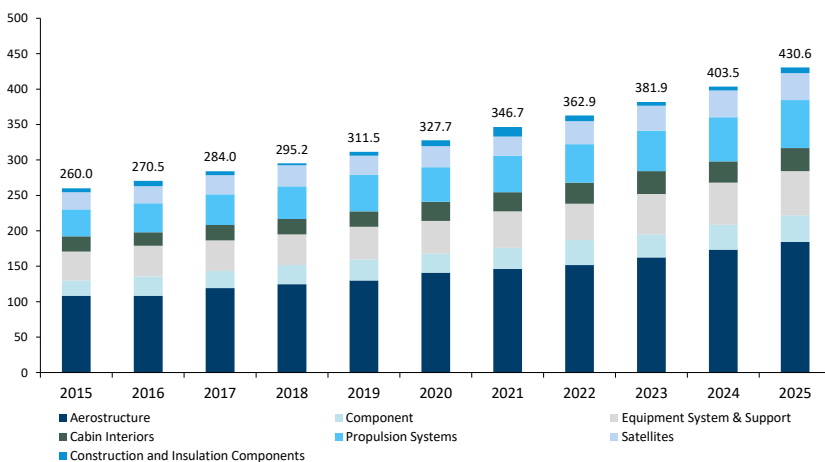
Suppliers who are in the best position to take advantage of opportunities created by the increasing use of plastics by manufacturers are those who have broad-based capabilities and experience in automated fiber placement, compression molding, and automated thermoforming technologies.

AEROSPACE AND DEFENSE TRADING MULTIPLES



Source: Capital IQ

NORTH AMERICA AEROSPACE PLASTIC GROWTH



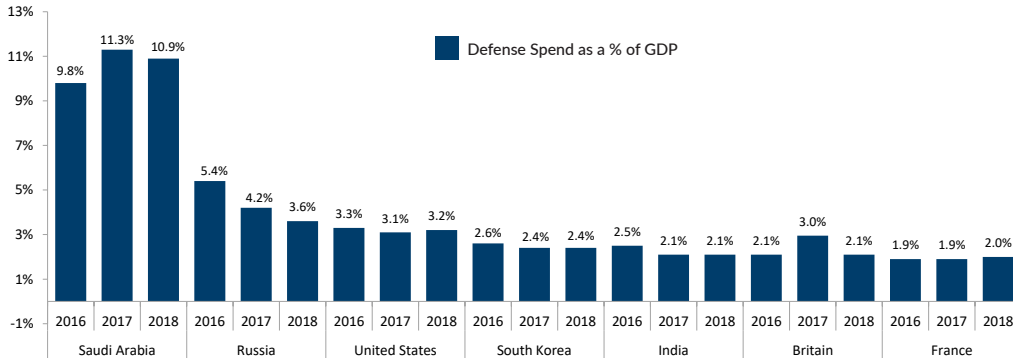
Source: Grand View Research



# Macroeconomic Trends & Signals

The aerospace and defense market in 2019 should experience robust growth, with increases in overall defense spending and weapons development, and steady growth in the commercial aviation market.

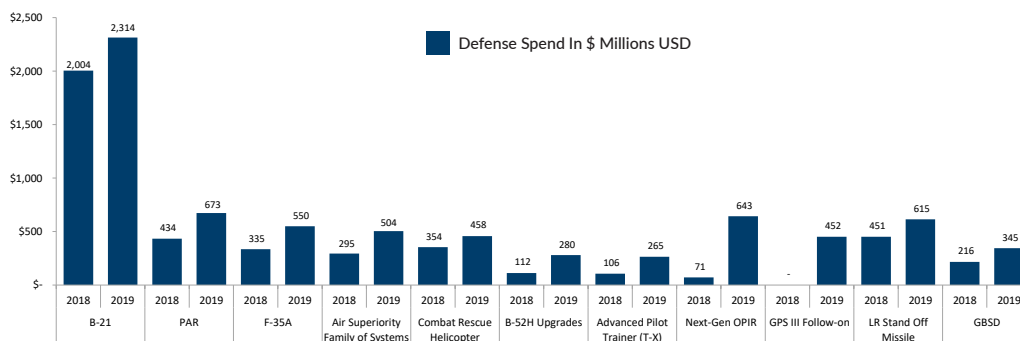
## GLOBAL DEFENSE SPENDING



Source: IISS & PMCF Estimates

- In defense, a main driver of growth is pressure from the US on NATO to meet a spending target of 2% of GDP, in response to growing geopolitical threats from Russia, the Middle East, and the Asia-Pacific region.

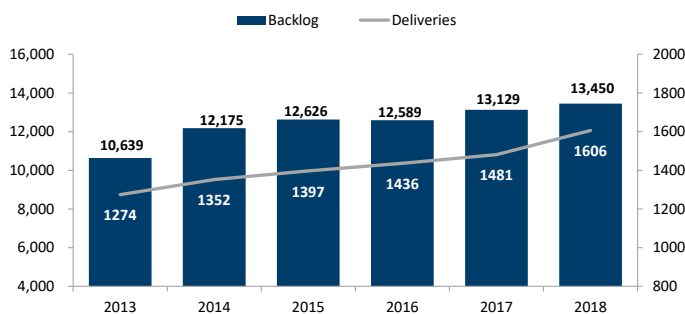
## MILITARY WEAPONS BUILD VOLUMES



Source: Air Force Budget - U.S. Department of Defense

- In the US, there have been funding increases for a number of key systems, including systems development and engineering for the Air Dominance Study and Long Range Stand Off (LRSO) missile system, the B-21 Long Range Strike Bomber, GPS III follow-on, Combat Rescue Helicopter (CRH), as well as other next-generation systems.

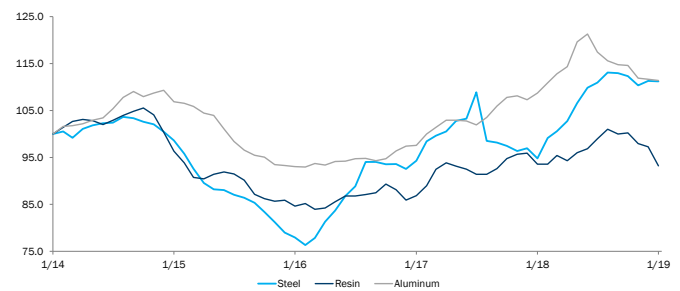
## COMMERCIAL AIRCRAFT DELIVERIES AND BACKLOG



Source: Boeing and Airbus Annual Reports

- In the commercial market, aircraft orders increased again in 2018, extending a growth trend that began in 2013, although there was some weakening in wide-body orders. Expansion of passenger numbers, tourist volumes, and new routes, particularly in developing markets, will continue to support aircraft and components order volumes and modernization in 2019.
- The backlog in commercial aircraft orders reached 13,450 orders in 2018, the fifth straight year of increases. Likewise, aircraft deliveries increased to 1,606 in 2018.

## RAW MATERIALS



Source: Federal Reserve Bank of St. Louis

Note: Indices anchored at 100.0 on Jan 2014

- The embrace of new technologies is being driven in part by volatile raw materials prices. Manufacturers/suppliers are contending with high prices of steel, aluminum, titanium, copper, resins, and plastics. Although there has been some recent price moderation, the persistence of elevated prices has emphasized the need for companies to optimize efficiency and cost savings. While tariff exemption waivers have begun flowing through the network and supply chain somewhat diminishing the criticality of potential surcharges, the risk of high costs as a result of tariffs remain a concern.

# Aerospace & Defense M&A Activity

## SELECT A&D TRANSACTIONS

(\$ in Millions)

Announced Date	Target	Buyer	Implied EV	EV/TTM Revenue	EV/TTM EBITDA
Dec-18	Sparton Corporation	Cerberus Capital Management, L.P.	246.1	0.6	9.1
Nov-18	ARC Technologies, Inc.	Hexcel Corporation	160.0	n/a	n/a
Nov-18	Diamorph AB	Epiris LLP	165.0	n/a	n/a
Nov-18	Q Series / de Havillard (Bombardier)	Longview Aircraft Company of Canada Limited	300.0	n/a	n/a
Oct-18	United Flexible, Inc.	Smiths Group plc	345.0	n/a	n/a
Oct-18	Agile Magnetics, Inc.	Standex International Corporation	39.2	2.3	n/a
Sep-18	MRA Systems, LLC	Vision Technologies Aerospace Incorporated	506.0	1.2x	n/a
Sep-18	WSI Industries, Inc.	Polaris Industries Inc. (Delaware)	22.4	0.6	8.7
Jul-18	Germane Systems LC	Themis Computer, Inc.	45.0	n/a	10.0
Jul-18	Jet Parts Engineering, Inc.	Vance Street Capital	n/a	n/a	n/a
Jul-18	Cone Drive Operations, Inc.	The Timken Company	245.0	2.6	12.0
Jul-18	SKANDIA, Inc.	TransDigm Group Incorporated	84.0	3.2	n/a
Jul-18	Winchester Interconnect	Aptiv PLC	682.0	2.7	n/a
Jul-18	Perfekta, Inc.	Cadence Aerospace, LLC	n/a	n/a	n/a
Jul-18	Applied Defense Solutions, Inc.	L3 Technologies, Inc.	50.0	n/a	12.0
May-18	Hirschler Manufacturing Inc.	Mecadaq Group	n/a	n/a	n/a
May-18	ASCO Industries	Spirit AeroSystems Holdings, Inc.	604.0	n/a	n/a

## KEY DEAL HIGHLIGHTS

### Portfolio & Market Expansion

Hexcel Corporation acquires ARC Technologies

Hexcel Corporation (NYSE: HXL) announced the acquisition of ARC Technologies Inc. on November 30, 2018, for \$160 million. Founded in 1988, ARC Technologies is a leading supplier of RF/EMI and microwave-absorbing composites for military and aerospace applications, and employs 170 people in two facilities in Amesbury, MA, generating approximately \$50 million in annual revenue. The deal is seen to bolster Hexcel's portfolio in structural composites and thermoplastics, and provide expanded opportunities for end market penetration and overall growth. Following the announcement, ARC Technologies founder and CEO Daniel P. Healey III commented, "This acquisition represents a major step in strengthening our capabilities in RF absorbing materials, thermoplastic products and specialty composites. Hexcel has a well-known industry reputation for producing high-performance structural materials."

### Platform Investment

Vance Street Capital Partners acquires Jet Parts Engineering

On July 30, 2018, Los Angeles-based Vance Street Capital LLC announced the recapitalization of Seattle's Jet Parts Engineering Inc., for an undisclosed sum. Founded in 1994 by Anu Goel, JPE is a leading developer of proprietary OEM-alternative parts and repair services for the commercial aerospace industry. The capital infusion is expected to help JPE expand its market for proprietary aftermarket components and complementary proprietary component repair services. Vance Street Managing Partner Richard Crowell said in a statement, "The JPE transaction embodies all of the key characteristics our firm looks for in a deal - the opportunity to partner with a world-class management team, a business with a strong position in a growing market, and a business model that is 100% proprietary and aftermarket."

# Strategic Planning for Sale

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## Plan Before You Think You Need to Plan

Although specific planning items are different for every company, the longer the runway to the sale process, the greater are the opportunities to identify, develop and support value-enhancing processes and action items, such as optimizing customer and end market mix/concentration or accounting processes. Start early, before you think you need to begin planning.



## Take a Holistic Approach to Planning for a Sale

Understanding the financial and non-financial factors that can affect the outcome of a transaction is critical to maximizing value. Take a broad look at the business, and consider all factors carefully.

Examples may include:

### Financial Considerations

- Growth opportunities
- Margin levels
- Revenue visibility
- Key performance indicators
- Employee compensation & incentives

### Nonfinancial Considerations

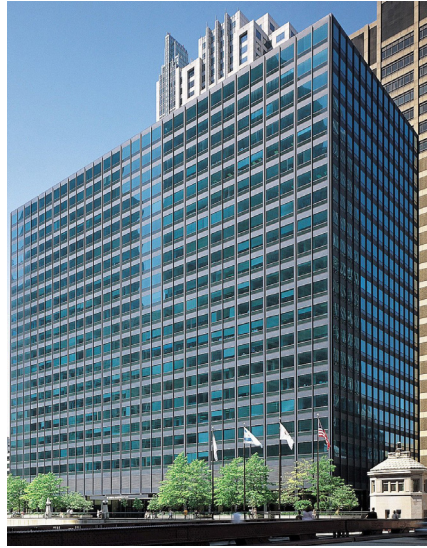
- Customer stickiness
- Risk management
- Systems & processes – repeatability
- Management gaps & succession

## Develop an Effective Action Plan

Build on the identified strategy and areas of focus to create an effective plan to carry out sale readiness and value optimization. This is one area in which the help of an experienced investment banker can be invaluable in preparing the business for a transaction and assisting in executing the action plan.



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