

# Aerospace and Defense

## 2019: Year-end review

### Primary influences on the sector

Supported by a strong underlying economy and a record-breaking U.S. defense budget of nearly \$700 billion, 2019 was an outstanding year for the A&D sector overall. Even compared to the S&P 500's 29% gain, most A&D stalwarts delivered robust results, as indicated by Airbus' 55% advance and 34% growth for Honeywell.

Despite the sector's strong performance, the most notable development in 2019 was negative: the literal grounding of Boeing's 737 MAX in March. While a clear obstacle for Boeing, the lack of clarity around 737 MAX will create incremental opportunities for companies that service and maintain existing jets as well as suppliers focused on providing aftermarket components.

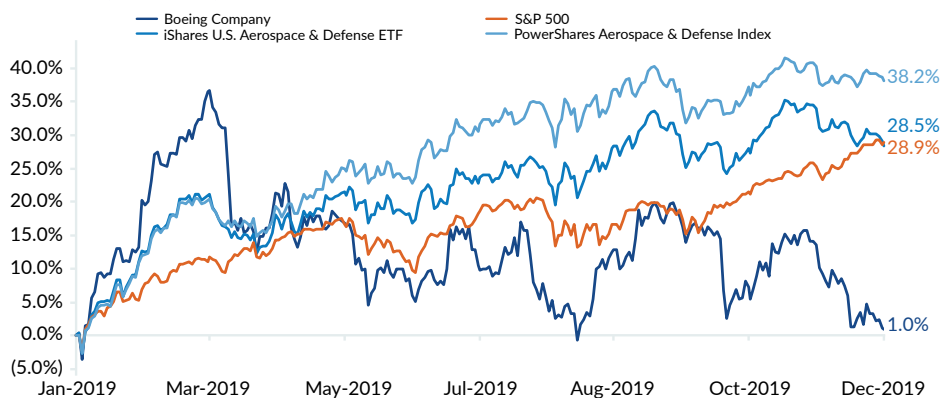


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**CHART 1: AEROSPACE & DEFENSE ETF SHARE PRICE PERFORMANCE AGAINST THE S&P 500 (YE 2019)**



Source: Factset. Past performance is not indicative of future results.

## M&A overview

Likely the most discussed trend, evidenced by both the quantity and deal value of mergers announced in 2019, is the race for scale throughout the supply chain. 2019 more than doubled 2018's announced deal value, including the massive merger of United Technology Corporation and Raytheon, with a market value estimated at \$125 billion, among several other notable transactions:

- Raytheon Company / United Technologies Corporation (Pending)
- The Boeing Company / Encore Aerospace LLC (Pending)
- Sekisui Chemical Co., Ltd. / AIM Aerospace, Inc.
- Advent International / Cobham plc
- CVC Capital / Ontic

Run-rate transaction activity for the second half of 2019 represents the busiest period of deal-making in the past decade, including strong presence from increasingly active private equity acquirers. In keeping with recent historical trends, few deals transacted within the \$500 million to \$1.0 billion range. Most of the M&A activity by volume remains centered around mid-sized A&D platforms, which attract significant interest and value due to their scarcity, especially considering the increased focus on growth further down the supply chain and across end products.

## Select Mesirow advised M&A transactions

- Sale of Heads Up Technologies to JLL Partners, LLC: Heads Up, headquartered in Carrollton, TX, provides highly-engineered proprietary cockpit, cabin and aircraft electrical components and systems to the business and commercial aviation markets.
- Licensing of several Meggitt Aerospace product lines to Ontic: Meggitt PLC entered into an exclusive license agreement with Ontic. Product lines include signal conditioners, chip detectors, cockpit indicators and connector harnesses used in aerospace applications, and represent a portfolio that is expected to extend for at least the next 15 years.
- Sale of Avalon Precision Casting to Sigma Electric Manufacturing Corporation: Avalon is a full-service investment casting platform, supplying ferrous and non-ferrous metal castings to customers in the aerospace, defense, HVAC, power, agriculture, and oil & gas markets.
- Sale of Base2 Solutions to Belcan, LLC: Base2 specializes in providing technology consulting and engineering solutions that address complex business issues in industries requiring niche technical knowledge, providing services including custom software development, DevOps, information security, and systems engineering and integration.
- Sale of Spectralux Corporation's Human-Machine Interface product line to Radiant Power Corporation: Spectralux's HMI component product line offers OEMs and operators in the commercial air transport, business and military aerospace markets the ability to comply with aviation requirements for aircraft systems governing performance, control, and lighting.

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SELL-SIDE ADVISOR



HEADS UP TECHNOLOGIES

a portfolio company of affiliates of



LUTHER KING CAPITAL MANAGEMENT

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HAS BEEN ACQUIRED BY



SELL-SIDE ADVISOR

certain assets of




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HAVE BEEN EXCLUSIVELY LICENSED BY



A BBA Aviation company

SELL-SIDE ADVISOR



AVALON PMI PRECISION METALSMITHS

WHERE THE FUTURE IS TAKING SHAPE

a portfolio company of




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HAS BEEN ACQUIRED BY




SIGMA ELECTRIC MANUFACTURING CORP.

a portfolio company of




ARGAND PARTNERS

SELL-SIDE ADVISOR





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HAS SOLD




base2 solutions<sub>2</sub>

to




Belcan

a portfolio company of



ae Industrial Partners

SELL-SIDE ADVISOR




Spectralux<sup>®</sup> avionics

Human Machine Interface Business


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HAS BEEN ACQUIRED BY



RADIANT POWER CORP.

a wholly owned subsidiary

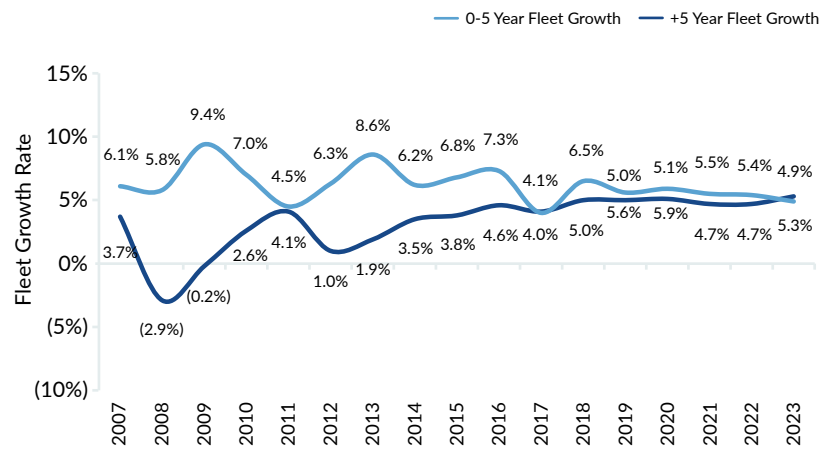


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## Indicators to watch

- Boeing 737 MAX Return to Service.** The MAX grounding has strained the Boeing supply chain, demonstrating how quickly changes in production activity can negatively impact smaller industry participants with outsized exposure to particular aircraft platform. Boeing emphasized that MAX remains a major component of its 20-year forecast and maintains that the aircraft will resume service in the second half of 2020.
- Book-to-Bill Ratio.** The industry experienced a book-to-bill of less than one in 2019, indicating that OEMs are delivering aircraft faster than they are receiving new orders. From an M&A perspective, Mesirow is monitoring this trend closely as a falling book-to-bill reduces revenue visibility and creates uncertainty surrounding the order book, ultimately putting downward pressure on valuation.
- Passenger Traffic Statistics.** Passenger traffic trends dictate buying trends among the airlines and the rate at which manufacturers produce aircraft. Recent statistics (even prior to the negative impact of COVID-19) indicate slowing global air traffic relative to the last several years, which have been well above historical average levels. Such trends will need to be monitored closely as industry constituents work to maintain a healthy supply and demand balance, particularly within the wide body market.
- China Tariffs.** Certain A&D electronics may be subject to tariffs, and any permanent resolution in the Chinese trade standoff would likely be a boost to suppliers.
- Airshow Orders:** 2019 represented the first down year since 2016 for airshow orders. The 2019 Paris Air Show's 866 orders reflected the second lowest order volume over the last seven years. A bounce back at the 2020 Farnborough International Airshow would provide an important boost for aircraft OEMs.

CHART 2: FLEET GROWTH RATE BY AGE SEGMENT



Sources: IATA, Goldman Sachs.

**“We remain cautiously optimistic and anticipate continued M&A activity as cost cutting and increased production demand drives suppliers to new economies of scale.”**

## Outlook

While a number of potential headwinds exist – including the 737 MAX grounding, COVID-19 concerns, Brexit fallout and U.S. / China trade discussions and a presidential election - Mesirow anticipates another strong year for aerospace and defense M&A activity in 2020.

The COVID-19 virus has created significant uncertainty in global transportation markets. While passenger traffic will surely be negatively impacted over the coming months, the secular trends impacting growth will remain long after COVID-19 fades into memory. Subject to Boeing executing on the return to service of the 737 MAX, we remain cautiously optimistic and anticipate continued M&A activity as cost cutting and increased production demand drives suppliers to new economies of scale. Further, buyers can be expected to emphasize companies with a strong after market presence as the global fleet continues to grow and age. It is also reasonable to expect that defense spending will remain robust given the broader geopolitical environment.

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## Dedicated Advisor to the Aerospace and Defense Sector

Mesirow Investment Banking is consistently focused on elevating the experience for our clients. With extensive sector-specific expertise and deep long-standing relationships, our dedicated aerospace and defense team has a proven track record of completing highly tailored and successful transactions. Our highest priority is helping individuals and organizations achieve their financial and strategic goals.

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