

# Aerospace Sector Prepares for Launch; Globalization and a growing backlog is stimulating activity in the space

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The aerospace sector is historically among the more cyclical areas for investors. Observers, considering the funding issues at NASA or the consolidation and distress among the airlines, might assume the space is still in the midst of a downswing. Those following the M&A activity in the sector, however, may pick up on an entirely different story -- one that reflects the rapid growth of an end-market that extends far beyond US shores.

"We are in the middle of an upcycle with significant global demand," cites Jon Nemo, a managing director at Harris Williams & Co. "All signs point to several more years of strong, sustainable growth."

Nemo, who heads Harris Williams' aerospace, defense and government services coverage, notes that traditionally, the sector runs hot and cold. "Boeing and Airbus build up on orders, deliver airplanes and then wait for the next wave of demand," he cites. Today, however, observers believe that the dynamics have changed.

"Globalization has made the demand for aviation less elastic," says Scott Thompson, the aerospace and defense leader at PricewaterhouseCoopers. He cites that beyond new end markets, global deployment of personnel and just-in-time supply chains have helped smooth out the volatility.

There is already a backlog of about seven years on new planes and in the last nine months Boeing has twice increased its production rates for both the 777 and the 737 aircraft. Airbus will increase production of the A320 to 40 planes per month in 2012, followed by the launch of the A320 NEO in 2016, which will produce 4,000 planes in 15 years.

For buyers and sellers, this newfound predictability has translated into dealflow. PwC, in the first quarter, tallied 17 deals in the aerospace and defense sector, worth a combined \$9.5 billion. This is up from 10 transactions worth \$5.7 billion in the corresponding period last year.

For the most part, it's been the strategic buyers who have been driving the activity. In March, Netherlands-based Eurocopter Holding agreed to buy Canadian-based Vector Aerospace Corp. for \$637 million, while Seibte Vermoegensver-Waltungsgesellschaft Zeus, a platform put together by Daimler AG and Rolls Royce Group,

bought Tognum AG. The deal, for the No. 2 global manufacturer of high-speed engines, fetched a whopping \$4.38 billion. Also, in the middle market, there was Alcoa's purchase of TransDigm Group's fastener business for \$240 million, and BBA Aviation's \$63 million deal for General Electric's fuel measurement division.

But that's not to say that PE has been completely shut out. Last year, for instance, Odyssey Investment Partners, KRG Capital and Linsalata Capital Partners all launched platforms with deals for Wencor Group, PAS Technologies and Whitcraft, respectively. And all three will likely be pursuing an add-on strategy.

"The OEMs have record backlogs; new platforms are coming online; air traffic is healthy; and, global economic activity is strong -- all factors that are driving demand and a strong long-term growth outlook," observes Nemo. But he adds that while a "very healthy demand" is in place, buyers are finding "a lack of high-quality, actionable supply."

That could change as sponsors -- particularly active in the segment during 2005 through 2007 -- look to exit. Michael Misantone, a director with aerospace and defense investment bank Kipps DeSanto, notes that since 2008, when the industry "hit a wall," many sponsors were forced to pump more equity into their investments, while pursuing strategies to streamline operations. Misantone notes that today, many of those sponsors are nearing exits. And if the credit markets continue to improve, he says, PE could again be competitive for deals in the space. "It's a sector where they have consistently made money," Misantone adds.

To wit, The Carlyle Group, last year, sold Vought Aircraft Industries to Triumph Group after seven years. Last September, it was JLL Partners' turn, selling McKechnie Aerospace to TransDigm Group in an all-cash deal valued at \$1.27 billion. The publicly held TransDigm, it's worth noting, counts Warburg Pincus and Berkshire Partners as investors.

While globalization has provided support for the sector, prospective buyers will find that it brings competition as well. Cirrus Industries' sale to China's Aviation Industries Corp., for instance, underscores one hotbed of interest.

Still, investors will gladly opt for stability in the sector over a lingering uncertainty that scares away all other buyers. Gary Ran, the founder and chairman of Telemus Capital Partners, notes that post credit crisis, substantial demand still exists for both equity and debt. Because of that, Ran says, the sector represents a "ripe opportunity" for returns.