



Mergers & Acquisitions in the Third Quarter of 2010: Defence, Security and Military Aerospace

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M&A THIRD QUARTER ANALYSIS

Gaining ground

A new class of mid-tier players and the expansion of the cyber security land grab beyond the US are trends in IHS Jane's and Grant Thornton's review of third quarter M&A activity. Guy Anderson and Ian Wilson report

Mergers and acquisitions in the defence sector remained buoyant during the third quarter of 2010 (Q310), bolstered by strong activity among top tier contractors.

The continued upward trend of 2010 was notable: the volume of announced activity for the first three quarters was up 55 per cent on the same nine months in 2008, while the total disclosed values of transactions leapt 286 per cent to USD17 billion. The bulk of deal activity took place in the United States, the scene of 52 per cent of transactions during the quarter, based on the location of targets.

Large firms in both the UK and US drove activity as both buyers and sellers and a growing level of acquisition activity by French companies, with Safran at the fore, was also noticeable. Upper tier contractors were behind 47 per cent of deals as buyers during the third quarter, a percentage unchanged from the previous quarter. This activity reflects strong financial positions.

It was also notable that defence contractors were behind 25 per cent of divestments, an indication of the reshuffle of portfolios that has been apparent throughout the year and a trend which created opportunities for both private equity buyers and tier 1 consolidators.

The heavy emphasis on US deals continued with 52 per cent of deals having taken place in the world's largest market during the quarter – a constant trend over the past decade.

Priority market sectors

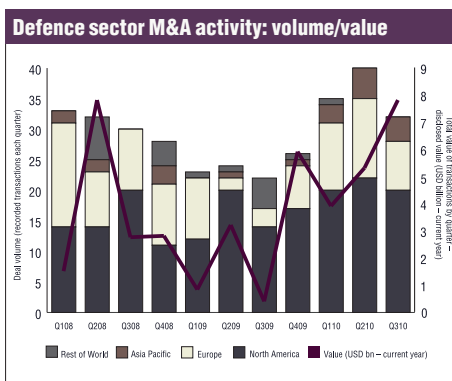
Cyber security: land grab beyond the US. The acquisition surge in cyber security domains continued during the quarter. More than a third of all defence transactions involved targets with some cyber security capabilities. Core defence companies and IT firms such as Hewlett Packard bolstered capabilities in the sector.

Purchases in other markets demonstrated a move beyond relatively established US market. EADS' subsidiary Cassidian (formerly EADS Defence & Security) purchased the UK's Regency Consultancy during the quarter: a cyber security outfit that will form the basis of EADS' cyber security strategy in the UK market. Raytheon purchased Australian IT security firm Compucat during the first quarter of the year.

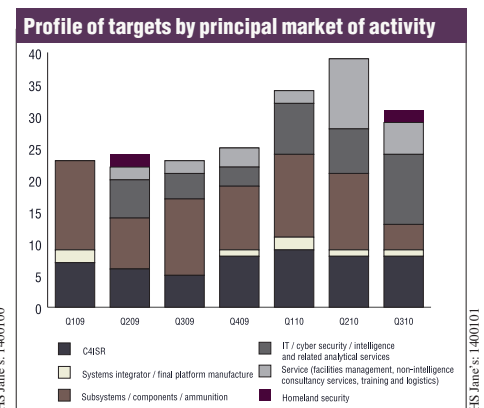
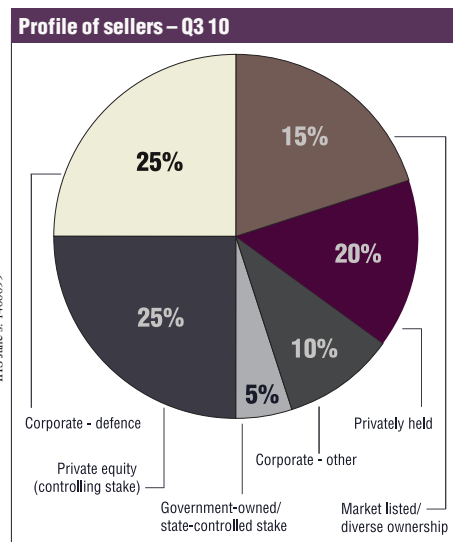
Cyber security acquisitions activity in established markets beyond the US, especially Europe, is likely to increase in the coming months as the nature of opportunities becomes less nebulous.

Behind-front-line services provision. Activity continued in the US military services sector with Aecom Technology Corporation's purchase of McNeil Technologies from private equity firm Veritas. McNeil provides professional services to the US military and government agencies such as language translation, outsourcing and security.

The deal, valued at USD355 million and announced in August, echoed Dyncorp



Source: Jane's Defence Industry and Markets – M&A transactions dataset. Volume covers publicly disclosed deals announced but not necessarily completed during the quarter. Value shows total disclosed value by quarter – current year USD billion.



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International's sale to Cerberus Capital Management for USD1.5 billion in April. Both companies provide "soft" intelligence services such as cultural and linguistic skills – a priority area of US military spending highlighted by the *Quadrennial Defense Review* of February 2010. They also have a presence in the logistics and services domains, an area that previous waves of consolidation bypassed and which will be of greater importance as the tempo of Middle Eastern operations shifts from combat to sustainment.

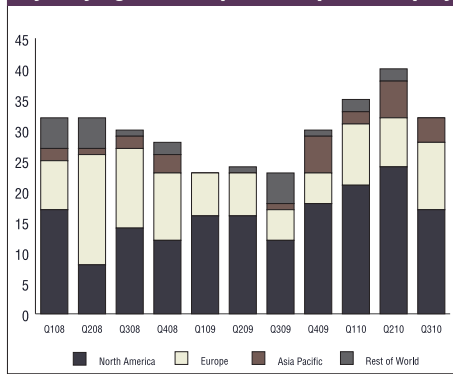
Given the heavy support costs of current operations – keeping soldiers in Iraq currently averages USD600 per man each month – the opportunity to reduce costs through outsourcing will prove compelling.

Consolidation in military services is likely to continue on both sides of the Atlantic. It would be reasonable to expect US companies such as technical services provider Mantech International and tactical equipment and logistics service provider ADS to come to the fore, as well as UK support services organisations such as Babcock International and Serco.

Drivers of deal activity

Three themes are all connected to the changing spending priorities of governments seeking to reshape their military capabilities while reducing budget deficits: divestment of non-core

Buyers by region of incorporation of parent company



IHS June 5, 1400102

assets by major defence players; the broadening of the cyber security assets land grab beyond the US; and the continued emergence of opportunities stemming from US Organisational Conflict of Interest (OCI) rules.

Divestment

BAE Systems looked at "strategic options" for its aerospace systems and hybrid drive unit, Platform Solutions; QinetiQ sold its US access control business S&IS to ManTech International; Cobham sold off its French MRO unit Satori SAS, while Northrop Grumman continued to look towards the sale of its shipbuilding interests, with a development probable this quarter.

Improving the position of balance sheets was one motivation, particularly in the cases of QinetiQ and Cobham, although the need to assuage shareholder concerns by returning value is likely to have been a factor in some cases such as Northrop Grumman. It is notable that General Dynamics pursued a strategy of business unit sales to return cash to shareholders during the downturn of the 1990s.

However, given the current strength of most defence primes' balance sheets, the greater motivation for these non-core divestitures is to fund further acquisitions. The goal for many is the redeployment of capital from moribund, non-core sectors to priority areas. For example, BAE Systems is looking to the sale of PS – a deal that could raise up to USD2 billion – with a view to continuing its push into the C4ISR and intelligence services areas.

Other prime contractors are expected follow the examples of QinetiQ, Cobham and BAE Systems. To an extent, the reshuffling of portfolios with individual business units passing from defence companies to other strategic buyers is likely, although the opportunity for private equity buyers to acquire groups of businesses and thus emerge as a new class of midtier player is also plausible.

Such an approach led to the creation of companies such as L-3 Communications and DRS Technologies. A number of financial sponsors, including Carlyle, Warburg Pincus and JLL,

Market intelligence: signposts from the third quarter

Cobham Cobham's sale of French MRO outfit Satori SAS on 29 September is consistent with the group's repositioning of its portfolio. Reinvestment of the EUR7.9 million (USD10.9 million) proceeds in fresh acquisitions is likely. Cobham has recently looked at the C4ISR, surveillance and SATCOM markets.

Forcit Finnish munitions group Forcit Defence is targeting European acquisitions in the EUR50 million revenues range to underpin international expansion. Electronics firms in the defence sector and raw materials providers in Finland and beyond are in the group's sights.

Saab Sweden's Saab is eyeing acquisition opportunities in Canada's three military branches, although its emphasis on crisis management, first response and "oil and gas in the public sector space" is notable. Offset obligations are likely to sharpen the group's focus on acquisitions.

Harris The UK arm of US communications group Harris Systems is in "acquisitions mode" following the purchase of Caprock Communications. Harris is the bridgehead to the group's push into the Europe, Middle East and Africa (EMEA) markets. Cyber security is an area of interest.

Marshall In September, Marshall Land Systems held talks with a number of UK companies with a view to an acquisition. MLS was looking at companies active in the UK military land systems domains with turnover in the region of GBP18 million (USD28.47 million) a year. Such a deal would point to more UK land sector consolidation.

General Dynamics UK Dr Sandy Wilson, managing director of General Dynamics UK (GDUK), is seeking a "game changing" acquisition in the wake of the group's purchase of sensors and surveillance systems manufacturer Kylmar. Specific details are limited, although Wilson is looking to add another strand to GDUK's capabilities. The purchase of state-owned Defence Support Group would be plausible should the government proceed with a privatisation. GDUK and DSG are partnered on the UK Scout land systems programme.

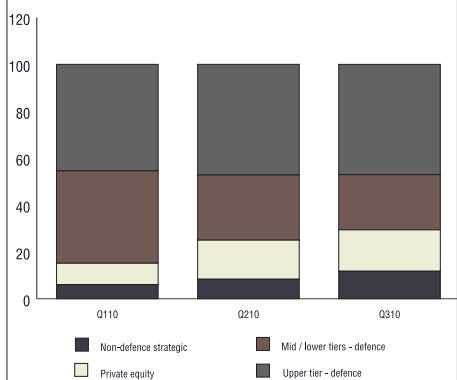
Korea Aerospace Industries The partial listing of Korea Aerospace Industries (KAI) is in motion. Hyundai Securities and Woori Investment & Securities were retained to sell part of the government's holding with an initial public offering (IPO) scheduled for June 2011. Samsung Techwin, Hyundai Motor Company and Doosan

Infracore – who each hold 20.45 per cent of KAI – are expected to reduce their holdings. Of greater interest will be the government's sale of a 30.5 per cent controlling stake after the IPO. Seoul appears open to a foreign strategic investor. BAE Systems, EADS, Boeing and Lockheed Martin have expressed interest.

Key Technologies UK group Key Technologies is gearing up for an IPO on the London Alternative Investment Market in 2011 to fund acquisitions in the defence sector after purchasing specialist ammunition manufacturer Primetake. Key's defence interests were previously limited to STS Defence, a maker of wiring harnesses and electronic assemblies for contractors such as BAE Systems, Honeywell and Thales. An emphasis on targets in the aerospace electronics domains in the GBP5 million to GBP20 million revenues range has been raised. Key is likely to expect GBP5 billion through the IPO.

LOM The privatisation of Czech aircraft repair and training company LOM was taken off the agenda by the Czech government in September. LOM had been heading towards private hands for about four years, with Czech Aero Vodochody owner Penta the most plausible acquirer.

Profile of buyers in 2010



have been linked with the BAE's Platform Solutions unit and Northrop Grumman's naval business.

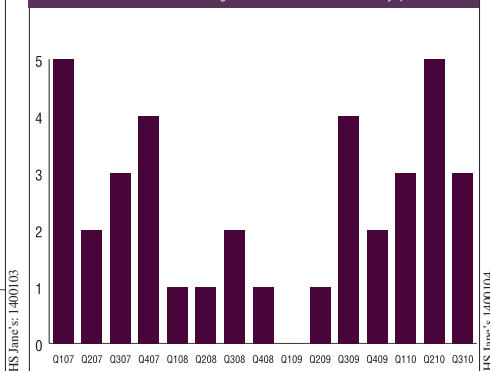
OCI rules

Opportunities stemming from OCI-related sell-offs continued during the quarter, notably Wyle Inc's purchase of systems engineering and technical assistance specialist CAS Inc from ITT Corporation. The sale of CAS was one of a series of spin-offs stemming from OCI concerns.

Lockheed Martin put its Enterprise Integration Group up for sale this year, while Northrop Grumman sold its TASC advisory unit at the close of 2009. The common thread is that divested businesses acted for or advised governments as systems engineering and technical assistance operators, while their parent

Transformational deal activity

Transactions with a disclosed value greater than USD500 – volume by quarter



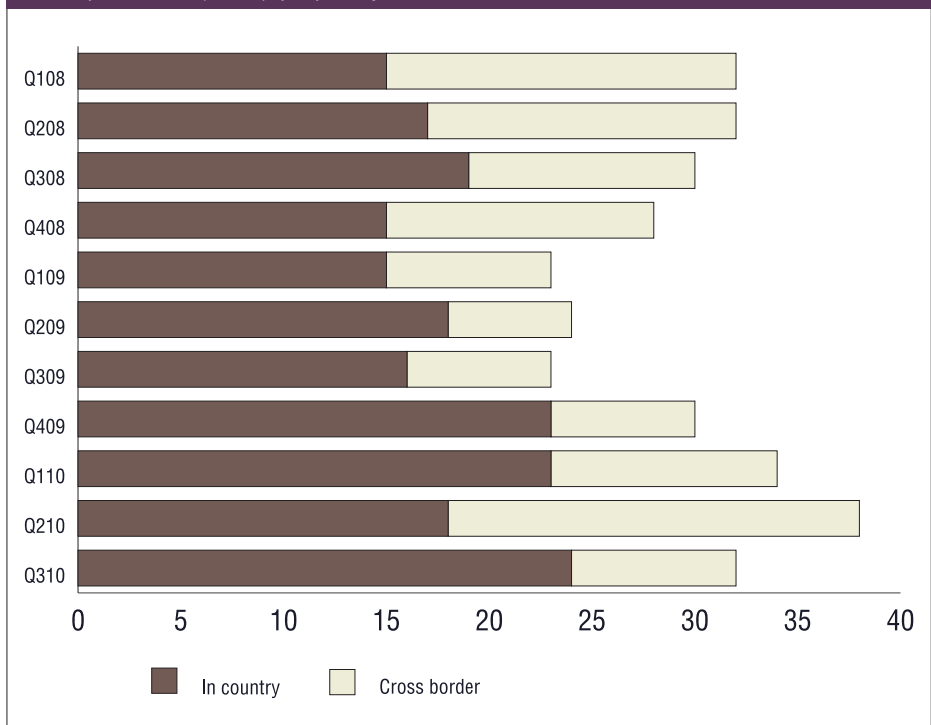
companies had the potential to bid for related contracts through other units.

OCI regulations are expected to be enshrined in legislation by the close of 2010. Private equity firms have been the principal beneficiaries of the carve-up so far: Wyle is backed by Court Square Capital Partners while TASC is now in the hands of General Atlantic and Kohlberg Kravis Roberts. Additional divestments are likely as the extent of US OCI rules become apparent and prime contractors are forced to take stock of their portfolios.

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Cross-border/in-country deals

Scale of activity based on location of parent company of buyer and target



Deal Focus Cassidian acquires Regency

21 September 2010: Cassidian, EADS' newly renamed defence and security business, acquired UK cyber security specialist Regency IT Consulting for an undisclosed sum.

Regency employs a pool of more than 20 cyber-security experts in the field of information assurance and managed IT security services, and serves both government and military customers.

Andrew Beckett, the co-founder of Regency, will continue to run the company and will lead EADS' cyber security business development in the UK. In October 2009, Cassidian and EADS Innovation Works (EADS' central research labs) grouped their cyber operations under its Cyber Security Customer Solutions Centre.

EADS rebranded its defence and security division as Cassidian on 17 September in a move that the company said is intended to remove confusion in the marketplace and to reflect the "maturity of integration within the division".

Significance / market outlook

The relatively small scale of the transaction belied its wider significance. Cyber security opportunities beyond the US are emerging as other markets look to meet such challenges and such acquisitions are likely to be replicated as defence players look to position for the best advantage. Raytheon's purchase of Australian cyber security firm Computac at the start of this year was another example of this emerging trend.

The UK's position was underlined in July by defence secretary Liam Fox's statement that "cyber [warfare] is a major threat and we have to invest heavily in that area". Australia's emphasis, meanwhile, was outlined in the May 2009 White Paper, which highlighted the "growing importance of operations in cyberspace".

Contact

The quarterly review of M&A activity in the defence domain is a joint project between IHS Jane's and UK financial services firm Grant Thornton. For more information, please contact:

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Defence sector M&A – Q3 2010

Buyer name	Buyer country	Target name
Six3 Systems	United States	Novii Design
VT Group	United States	Evergreen Unmanned Systems
UC RUSAL	Russia	China North Industries Corporation
Key Technologies	United Kingdom	Primetake
McNally Industries	United States	Pacific Aero Tech
Teledyne Bethos Inc	United States	Hafmynd
Cassidian (formerly EADS D&S)	France / Germany / Spain	Regency IT Consulting
BAE Systems	United Kingdom	Intelligence Services Group
Ultra Electronics	United Kingdom	Extec Integrated Systems
Safran	France	L-1 Identity Solutions
Microsemi Corporation	United States	Arxan Defence Systems
Global Defense Technologies & Systems	United States	Zytel Corporation
DCNS	France	Principia
Indra	Spain	Indra Espacio
BAE Systems	United Kingdom	Oasys Technology
Labinal	France	Harvard Custom Manufacturing (HCM)
BHIC Defence Technologies	Malaysia	Contraves Advanced Devices
Hewlett Packard	United States	Fortify Software
FLIR Systems	United States	ICX Technologies
Honeywell	United States	Sperian Protection
Kratos Defense & Security Solutions	United States	DEI Services Corporation
Chemring Group	United Kingdom	Roke Manor Research
Newberry Group	United States	cmdLabs
L-3 Communications	United States	Airborne Technologies
Wyle	United States	CAS Inc
Singapore Technologies Aerospace	Singapore	ST Aerospace Training Academy (STATA)
Aecom Technology Corporation	United States	McNeil Technologies
Science Applications International Corporation (SAIC)	United States	Reveal Imaging Technologies
Digital Barriers	United Kingdom	Overtis Group Ltd Solutions Division
Textron Systems	United States	Crane Wireless Monitoring Solutions (WMS)
The Boeing Company	United States	Narus
Hexagon	Sweden	Intergraph Corporation

Market sector of target	Country of target	Value (\$m)	% acquired	Target revenue (\$m)	Transaction value - EBITDA
Cyber security / intelligence services	United States	N/A	100	N/A	N/A
Unmanned systems	United States	N/A	100	N/A	N/A
N/A	China	N/A	100	N/A	N/A
Ammunition	United Kingdom	16.40	100	17.49	5.25 x
Aerospace MRO	United States	N/A	100	N/A	N/A
Unmanned systems	Iceland	N/A	100	N/A	N/A
Cyber security / IT services	United Kingdom	N/A	100	N/A	N/A
Systems engineering / intelligence services	United States	295.80	100	234	9 x
Electronics	United Kingdom	N/A	100		
homeland security	United States	1,190.00	100	486	19.3 x
IT services	United States	N/A	100	N/A	N/A
Cyber security / IT services	United States	26.80	100	20	N/A
Consultancy services	France	N/A	100	11.7	N/A
Space systems	Spain	50.00	49	N/A	N/A
C4ISR	United States	55.00	100	N/A	N/A
Aerospace subsystems	United States	N/A	100	N/A	N/A
Defence electronics	Malaysia	7.80	51	N/A	N/A
Cyber security / IT services	United States	N/A	100	N/A	N/A
Cyber security / IT services	United States	236.00	100	183.4	28 x
Safety products	France	1,400.00	28.28	1,039	13.5 x
Simulation and training	United States	6.00	100	15	4 x
Cyber security / IT services	United Kingdom	87.70	100	72	14 x
Cyber security / IT services	United States	N/A	100	N/A	N/A
Unmanned systems	United States	N/A	100	20	N/A
Systems engineering / intelligence services	United States	235.00	100	230	14 (est)
Simulation and training	Singapore	2.70	30	N/A	N/A
Military services	United States	355.00	100	249	15 (est)
Homeland security	United States	N/A	100	N/A	N/A
Cyber security / IT services	United Kingdom	4.90	100	N/A	45 x
Military services	United States	N/A	100	N/A	N/A
Cyber security / IT services	United States	N/A	100	N/A	N/A
IT services	United States	2,125.00	100	808	11.26 x

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Financial firepower: The cash and credit facilities of major defence organisations

Ticker	Name	Cash and ST Investments	Credit Facilities	Drawn	Available under Credit Facilities	Last updated	Total Liquidity
BA-GB	BAE Systems PLC	4,526	2,422	0	2,422	12/31/2009	6,948
BA-US	Boeing Co.	10,026	3,550	0	3,550	6/30/2010	13,576
GD-US	General Dynamics Corp.	1,853	3,275	0	3,275	7/4/2010	5,128
HON-US	Honeywell International Inc.	2,451	2,800	0	2,800	12/31/2009	5,251
LLL-US	L-3 Communications Holdings Inc.	1,023	1,000	33	967	6/25/2010	1,990
LMT-US	Lockheed Martin Corp.	3,599	1,500	0	1,500	6/27/2010	5,099
NOC-US	Northrop Grumman Corp.	2,098	2,000	300	1,700	6/30/2010	3,798
RTN-US	Raytheon Co.	2,385	1,500	3	1,497	6/27/2010	3,882
COL-US	Rockwell Collins Inc.	303	872	0	872	6/30/2010	1,175
RR-GB	Rolls-Royce Group PLC	4,982	3,472	0	3,472	12/31/2009	8,454
SAF-FR	SAFRAN S.A.	1,880	1,578	0	1,578	6/30/2010	3,458
TXT-US	Textron Inc.	1,191	3,000	1,000	2,000	7/3/2010	3,191
UTX-US	United Technologies Corp.	4,997	2,500	0	2,500	6/30/2010	7,497
HO-FR	Thales S.A.	2,717	2,152	0	2,152	6/30/2010	4,870
EAD-FR	European Aeronautic Defence & Space Co. EADS N.V.	11,422	4,304	0	4,304	6/30/2010	15,726