

# 2019: Mid-Year Review

Halfway through 2019, the Aerospace and Defense (“A&D”) sector’s strong performance remains shadowed by questions surrounding Boeing’s 737 MAX and signs of slowing global growth. The summer’s Paris Air Show (the “Show”), which featured both traditional industry behemoths and many small to mid-sized companies new to the Show, proved more so than in years past a microcosm of the broader industry environment. Mesirow Financial bankers in attendance of the Show spoke to clients and industry relationships throughout the supply chain that highlighted the following trends:

- While the global macro environment continues to burn long past expectations, the lingering threat of trade disputes and emergence of indicators of economic slowdown press the issue of, “what is coming next?”
- Over \$90 billion of deal value announced thus far, headlined by the massive Raytheon United Technologies Corporation (“UTC”) deal and supported by numerous smaller transactions, reflects an industrywide race to scale
- Announcements of new aircraft remained primarily focused on defense, with no reveals for Boeing’s highly-anticipated 797 aircraft
- While a down year with respect to total orders, OEM competition remains fierce with Airbus commanding 373 airshow commitments and Boeing securing a key commitment from International Airlines Group (“IAG”) for 200 of the beleaguered 737 MAX

## Macroeconomic Overview

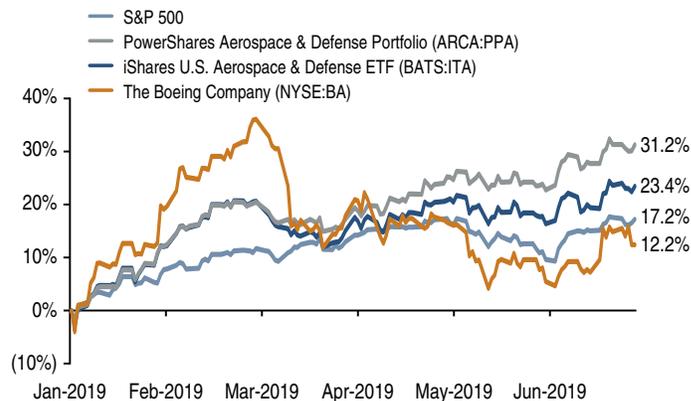
Following a disappointing finish to 2018, A&D equities saw substantial gains over the first half of 2019, outperforming the S&P 500. Even Boeing, though underperforming major indices, maintained a year to date gain of more than 12 percent despite significant negative press associated with 737 MAX grounding.

While markets recorded a tremendous start to 2019, they also left no doubt in the return of volatility and vulnerability to macroeconomic risk. Markets will continue to look toward accommodative monetary policy to soothe anxiety, while tariffs materialize and public company earnings face pressure.

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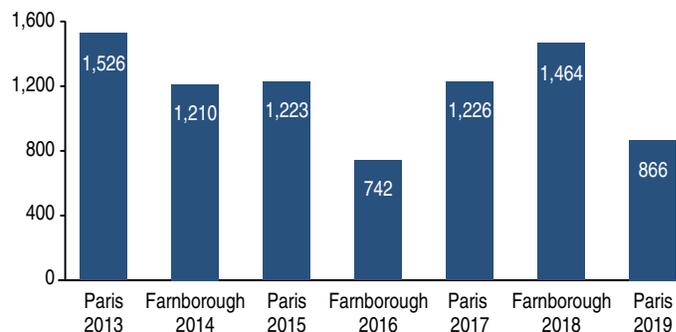
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**CHART 1 | Aerospace & Defense ETF Share Price Performance Against the S&P 500 (Through June 2019)**



Source: S&P Capital IQ.

**CHART 2 | Total Airshow Orders<sup>1</sup>**



Source: Flight Global.  
1. Includes new firm orders, previously undisclosed orders, LOIs, options, swaps and conversions.

### OEM Developments

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. Airbus edged out Boeing by securing 72 new firm orders and 301 commitments. Boeing, while commanding no new orders, received an important boost with International Airlines Group’s announcement of intent to purchase 200 737 MAX aircraft.

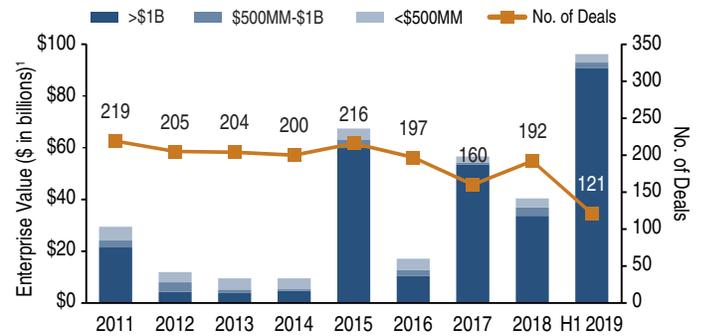
New aircraft announcements revealed the high level of OEM competition as well. While some new aircraft were announced (notably the Airbus A321XLR), no announcements were made by Boeing on the highly anticipated 797. Boeing’s delay, in conjunction with the 737 MAX grounding, suggests that Airbus has achieved a strong lead in the midsize passenger aircraft for the time being.

Although remaining quiet on the 797, Boeing addressed the issues with the grounded 737 MAX. Boeing emphasized that MAX remains a major component of its 20-year forecast and maintains that a fix is yet on the way; however, a solution has yet to be approved by the FAA. As we go to print, cost estimates suggest reimbursements for MAX service-related disruptions will amount to \$4.9 billion. Beyond the financial cost to Boeing, the MAX grounding has strained the Boeing supply chain, demonstrating how quickly production can slow and proving how significant the impact of halted activity can be for smaller industry participants with outsized exposure to particular aircraft. While there is much doubt that the 737 MAX will return to the air, the experience has rattled suppliers and OEMs alike.

### M&A Buzz

Likely the most discussed trend, evidenced by both the quantity and deal value of mergers announced in 2019, is the race for scale. In line with public A&D company outperformance to date in 2019, merger and acquisition (“M&A”) transactions volume and value both rallied to recent historical highs. Compared to 2018, 2019 has already more than doubled announced deal value on the shoulders of the massive United Technology Corporation (UTC) Raytheon combination. In addition to announced deal value, run rate transactions for full-year 2019 of 242 would represent the busiest year of deal making in the past decade. In keeping with recent historical trends, few deals transacted within the \$1.0 billion to \$500 million enterprise value range. Mesirow continues to see significant scarcity value for these midsized to large A&D platforms, especially considering the increased focus of growth further down the supply chain and across end products.

CHART 3 | Aggregate A&D Deal Volume by Transaction Range: 2011 through H1 2019



Source: S&P Capital IQ.  
1. Only includes deals with disclosed deal value.

In addition, anecdotal evidence for the race to scale exists in the marquee transactions announced in 2019. Notable transactions announced in H1 2019 include the following:

- Raytheon Company / United Technology Corporation (Pending)
- The Boeing Company / Encore Aerospace LLC (Pending)
- AIM Aerospace, Inc. / Sekusui Chemical Co., Ltd. (Pending)

In line with previous efforts to remove cost from their supply chain, Boeing has highlighted an appetite for a merger program focused around vertical integration. Raytheon’s decision to merge with UTC represents a similar focus on systems-based companies further up the value chain as opposed to significant platform exposure. The UTC Raytheon combination also served to increase the balance between aerospace and defense end markets. These efforts to reduce dependence on individual platforms and vendors creates new opportunities for private equity consolidators to build platforms across the aerospace supply chain. Sponsor-related deals made more than 12 percent of 2019 announcements, up nearly double from historical ranges of five to seven percent.

CHART 4 | Number of A&D Transactions by Buyer Type (% of total deal count): H1 2019



Source: S&P Capital IQ.

## Outlook for 2H 2019

While the record performance in 2019 thus far has been marred with concerns about the end of an economic cycle and the need to scale to remain competitive, Mesirow continues to see cause for optimism:

- 1 Long-term industry trends remain intact as income levels around the world continue to rise and commercial air travel continues to expand
- 2 Increased focus on diversification across products, end platforms and down the supply chain will continue to present small and midsize businesses with significant interest from acquirers
- 3 The long-contracted nature of aircraft orders and lengthy pipelines mitigate going concern business risks of platforms and suggest that suppliers will be able to weather the storm
- 4 Peacetime global spending on defense remains a focus as the global geopolitical landscape faces little material change since the end of 2018

We believe the second half of the year will see continued robust M&A activity and expect to see 2019 finish as a strong year for the A&D sector despite industry angst. ■

## Transaction Spotlights

### United Technologies, Inc.'s Merger with Raytheon Company

**Deal Value** \$52.4 Billion

**Enterprise Value / Revenue** 2.1x

**Enterprise Value / EBITDA** 11.7x

In June 2019, United Technologies Corporation announced it had entered into an agreement to acquire Raytheon Company, a major U.S. defense contractor, in a merger of equals. While Raytheon has historically been a global leader in the manufacturing of weapons, military devices and commercial electronics, the newly formed entity will focus equally on defense and commercial products, with plans to spend up to \$8 billion on R&D post-merger. Both companies cited the access to increased resources and supply chain overlap due to common customers as the rationale behind the merger. In addition to the expanded product mix, the combined entity estimates nearly a billion dollars in gross annual cost synergies. The companies have a combined market value of approximately \$121 billion and together will form the world's second-largest military contractor and significantly enhance product diversification.

### The Boeing Company's Purchase of Encore

**Implied Deal Value** N/A

**Enterprise Value / Revenue** N/A

**Enterprise Value / EBITDA** N/A

On June 14, 2018, The Boeing Company announced it had entered into an agreement through the Boeing Global Services business to acquire California-based Encore Group, an aerospace interiors company that designs, certifies and produces airplane galleys and seats for airlines. Boeing had partnered with Encore on seating design before—notably on the design of the Boeing 737 Sky Cabin's interior.

The acquisition continues Boeing's strategy to vertically integrate and bring in-house key components of its supply chain, as well as serving to strengthen internal capabilities and drive innovation within Boeing's cabin segment. Stan Deal, the president and CEO of Boeing Global Services, noted that the deal's vertical integration strategy provides benefits to both reducing acquisition and life cycle aircraft costs, which Boeing sees as a powerful lever for shareholder value creation. This total approach provides a unique and advantageous position for the company and fuels continued interest in services business growth.

Source: Reuters.

Note: Mesirow Financial did not represent any of the acquirers or targets in connection with the transactions noted on this page, and is not currently representing any of the listed acquirers or targets.

## Featured Mesirow Financial Deals



*a portfolio company of affiliates of*



has been acquired by



— Sell-side Advisor —

### Sale of Heads Up Technologies to JLL Partners, LLC

- Mesirow Financial acted as the lead financial advisor to Heads Up Technologies, Inc. (“Heads Up”) in its sale to JLL Partners, LLC
- Heads Up, headquartered in Carrollton, Texas, provides highly-engineered, proprietary cockpit, cabin and aircraft electrical components and systems to the business and commercial aviation markets
- Mesirow Financial developed a compelling investment thesis for Heads Up, highlighting the company’s proprietary and highly technical product solutions, strong heritage with demanding OEMs, reputation for excellent customer service and comprehensive in-house testing capabilities
- The transaction closed in July 2019

### Project EMERALD

*a business unit of*



has signed an exclusive licensing agreement with



*a subsidiary of*



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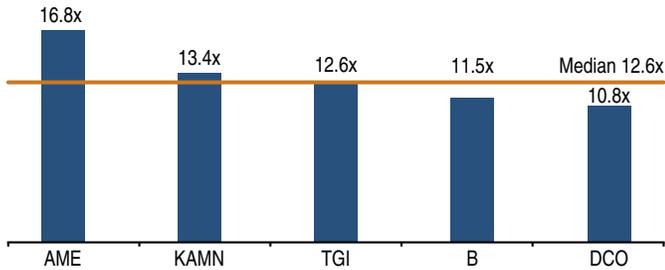
### Licensing of several of Meggitt’s aerospace chip detector lines to Ontic

- Mesirow Financial advised Meggitt PLC (“Meggitt”) (LSE: MGGT) in connection with a new exclusive license agreement with Ontic, a BBA Aviation plc (“BBA”) company
- The 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
- Mesirow Financial structured a highly tailored process, highlighting the company’s stable, contracted cash flow profile, as well as blue-chip customer base and end platforms
- The agreement was finalized in July 2019

# Public Company Trading Analysis

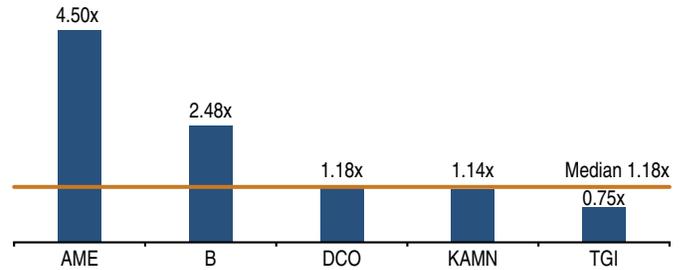
## Selected Aerospace Suppliers

CHART 5 | Enterprise Value / LTM EBITDA



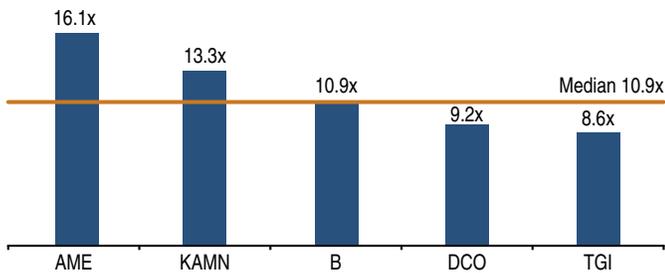
Source: Bloomberg, S&P Capital IQ.

CHART 6 | Enterprise Value / LTM Revenue



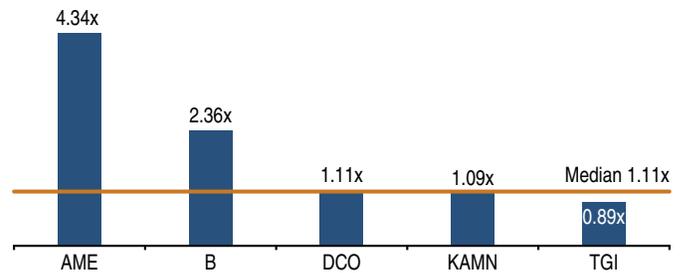
Source: Bloomberg, S&P Capital IQ.

CHART 7 | Enterprise Value / NTM EBITDA



Source: Bloomberg, S&P Capital IQ.

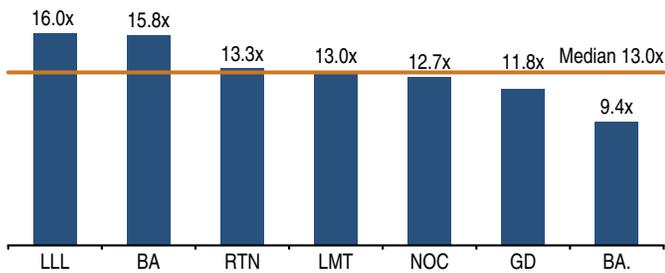
CHART 8 | Enterprise Value / NTM Revenue



Source: Bloomberg, S&P Capital IQ.

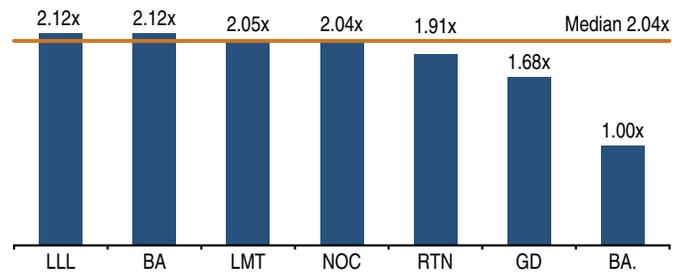
## Selected Defense and Prime Contractors

CHART 9 | Enterprise Value / LTM EBITDA



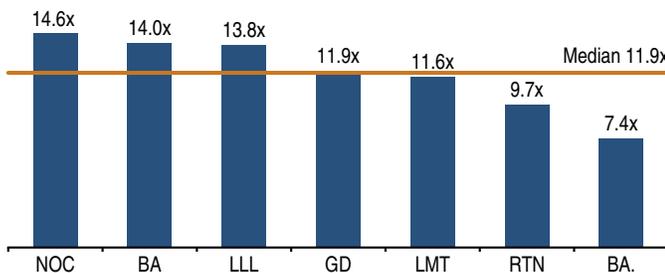
Source: Bloomberg, S&P Capital IQ.

CHART 10 | Enterprise Value / LTM Revenue



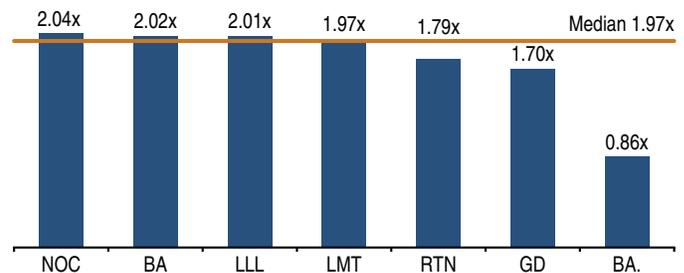
Source: Bloomberg, S&P Capital IQ.

CHART 11 | Enterprise Value / NTM EBITDA



Source: Bloomberg, S&P Capital IQ.

CHART 12 | Enterprise Value / NTM Revenue



Source: Bloomberg, S&P Capital IQ.

AME: Ametek, Inc., B: Barnes Group Inc., DCO: Ducommun Inc., KAMN: Kaman Corporation, TGI: Triumph Group Inc., BA.: BAE Systems plc, BA: The Boeing Company, GD: General Dynamics Corp., LLL: L-3 Communications Holdings Inc., LMT: Lockheed Martin Corporation, NOC: Northrop Grumman Corporation, RTN: Raytheon Co.

## Dedicated M&A Advisor to the Aerospace and Defense Sector

Mesirow Financial 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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