

News & Views: Aerospace & Defense

An Informational Resource

Watching & Waiting

The aerospace and defense industry has been watching and waiting ever since about \$40 billion was sliced from the proposed federal budget plan in March. And, while defense spending was not cut significantly then, the latest word from Washington suggests that additional cuts are being proposed

(Continued on page 2)

2011 M&A's Highest in 30 Years

Competition, spending cuts, and cheap money have combined to make 2011 a banner year for merger and acquisition activity in the aerospace and defense sector. And, according a recent PricewaterhouseCoopers (PwC) report, we'll see more of the same over the rest of this year. We haven't seen this level of activity since 1981.

First quarter deals with value greater than \$50 million totaled \$9.5 billion for 17 deals, an increase of about 67 percent in value and 70 percent in volume over the same period in 2010.

Six transactions were valued at over \$250 million, which increased the average deal value to \$558 million — compared to \$357 million in 2010. Two mega-deals, the Rolls-Royce and Daimler joint venture bid for Tognum AG and



the Northrop Grumman spin-off of the Huntington Ingalls shipbuilding business, drove most of the increase in deal value.

Foreign dealmakers played a key role in the strength of the first quarter's activity; these deals totaled \$5.7 billion, or about 60 percent of the first quarter's total value, and over half of the volume.

PwC's analysis predicts A&D deals to go even higher over the rest of this year for several reasons:

(Continued on page 2)

Inside this issue:

- Watching & Waiting **1**
- 2011 M&A's Highest in 30 Years **1**
- India Rejects U.S. & Russian Jet Fighters **1**
- Cost Reduction Drives New RFP Strategies **2**

India Rejects U.S. & Russian Jet Fighters

India's contract to build 126 to 200 jet fighters for at least \$12 billion will not go to U.S. companies Lockheed Martin and Boeing, nor will it go to Russia; that leaves just France's Dassault Rafale jet and the joint Eurofighter still in the running. The fact that neither Lockheed Martin's F-16 nor Boeing's F/A-18 were selected means no new American jobs; as a result, the U.S. ambassador to India said our government is, "greatly

disappointed."

This is one of the biggest aviation contracts in years and has significantly lowered business expectations for both Boeing and Lockheed Martin. Russia may be even more disappointed about this loss because India is its second-leading military client behind China, and because India rejected Russia's MiG-35, which is an updated version of the

(Continued on page 2)

Cost Reduction Drives New RFP Strategies

The U.S. Air Force answers the question — “How do we do more with less?” — by modifying its contract bidding processes. According to AviationWeek, the U.S. Air Force wants to stimulate competition in its Evolved Expendable

Launch Vehicle program (EELV). Right now, United Launch Alliance (ULA) has a virtual bidding monopoly.

The cost savings that the ULA had initially provided has since evaporated by inconsistent government ordering practices, increased parts costs and unrealized revenue from commercial launches. So, the Air Force wants to stabilize the costs of future EELV purchases.

Together with NASA and the National Reconnaissance Office, the Air Force is drawing up a list of criteria for companies that are seeking to sell launch services to the Pentagon; they will be tested in connection with the launch of NASA’s Deep Space Climate Observatory (DSCOVR) satellite, which will serve as an audition for a new launch provider. The new

criteria will be released in the next month or so.



The goals are to move from cost-plus deals, with the government paying for the cost of services, to fixed prices for the actual rockets and from “will-cost” prices to “should cost” prices based on market benchmarks.

generate over 50% of their revenues via government spending are the ones who have the most to lose. However spending on essential programs will likely remain intact and some areas, like cyber warfare, may actually see more funding.

As a result, some defense contractors are shifting their focus to areas that are unlikely to face budget cuts or to expand their commercial operations.

(Continued from page 1 - M&As)

- Large defense contractors will want to consolidate as defense budgets decline

- Large prime contractors will shift their portfolios toward growth segments: unmanned vehicles, cyber-security and others.

- Small and mid-sized companies will want to boost shareholder, capitalizing on the growing aerospace market and strong multiples.

(Continued from page 1 - Watching)

and that defense contractors will be affected.

Some legislative leaders predict that new cuts will total about \$200 billion annually. This forecast recognizes that something must give since the administration wants to shift dollars from major programs like defense so it can create jobs, improve infrastructure, develop clean energy and support health-care programs.

Companies that

(Continued from page 1 - India)

MiG-29 jet that India has already purchased.

The deal also is another indication that China’s and India’s growing economies are helping them become major military powers, controlling more and more of the global defense industry. The Stockholm International Peace Research Institute (SIPRI) identified India as the world’s biggest arms purchaser between 2006 and 2010 and Russia was its main supplier throughout.

To underscore this point, India and Russia recently agreed to jointly produce a fifth-generation fighter with stealth capabilities in a deal potentially worth up to \$30 billion.



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