

We are pleased to present the second issue of Squire Sanders' Global M&A Briefing, produced in association with Mergermarket.

Contents include:

Private equity activity – exiting and buying – played a role in the two biggest deals of 2012, which bodes well for future involvement in the sector going forward **(see page 3)**

APAC has grown its share of M&A in the sector. This trend looks likely to continue as a result of governments in the region increasing their aerospace, defense and government services spending **(see page 3)**

The aerospace sub-sector is expected to be busy in the mid-term, thanks to developments in the commercial arena **(see page 4)**

In the future, it looks likely that there will be an increased focus on services, as governments in the US and Western Europe scale back their military commitments and focus on threat mitigation **(see page 5)**

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Aerospace, Defense and Government Services

Squire Sanders Global M&A Briefing

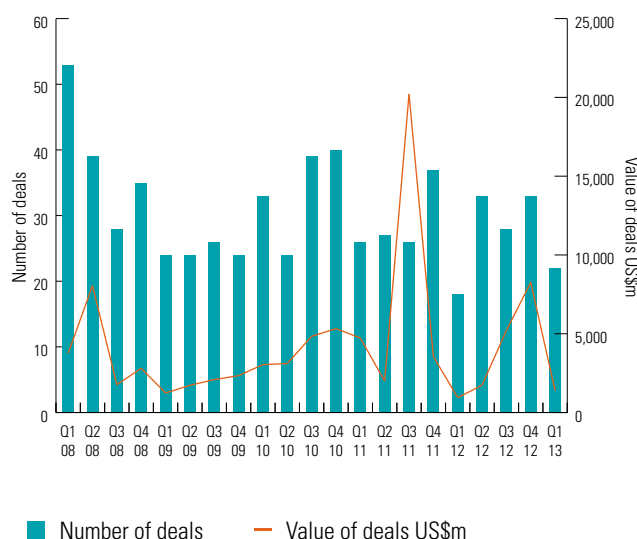
Market Review 2013

M&A in the aerospace, defense and government services sector remains appealing to a number of strategic players and financial investors. But the sector's constituent parts have experienced divergent trends, bringing different deal drivers to the fore across the three sub-sectors.

On one hand, the aerospace sub-sector is in the midst of a prolonged growth cycle. This has been bolstered by more energy efficient aircrafts and an uptick in air travel in developing markets, particularly in Asia. But the defense and government services sub-sectors have been weighed down by cuts to Western European and North American defense budgets. The nature of defense spending, most evident in the US, is also changing: there is a general shift away from a focus on armament toward threat mitigation. These shifts have likely raised more questions than answers for businesses reliant on government contracts.

Taking into account these different pulls, aerospace, defense and government services M&A has fared well,

Defense, Aerospace and Government Services Quarterly Trends



Aerospace, Defense and Government Services

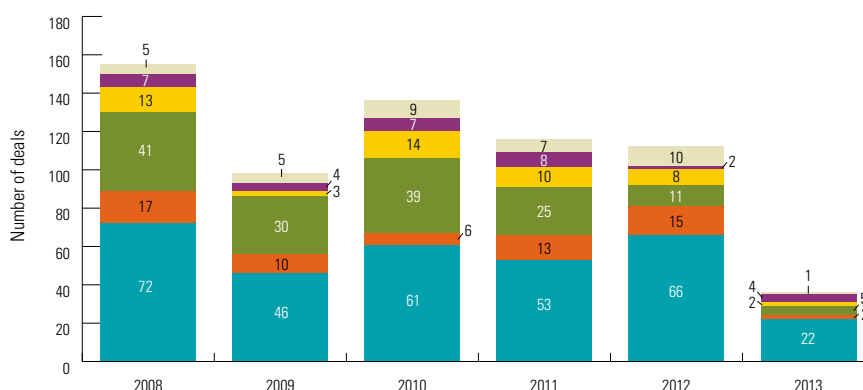
experiencing generally positive trends. Strategic buyers continue to look for opportunities to consolidate supply chains, grow market share and expand into new technologies. Financial investor interest also remains a stable, albeit small, part of the sector's overall growth story, indicating that those outside the sector see it as a safe bet for future growth.

In Q1 2013, M&A increased 22% and 46% year-on-year (YoY) in volume and value terms to 22 deals worth US\$1.4bn. This follows fairly solid activity in 2012, although volume decreased by a slim 3% to 112 deals, and value nearly halved to US\$16.2bn. However, the marked YoY decline in value was skewed by a lone blockbuster transaction announced in Q3 2011 and completed in Q3 2012: industrial conglomerate United Technologies Corporation's (UTC) acquisition of Goodrich for US\$17.9bn – the largest over the past five years by more than US\$10bn. The acquisition enhanced UTC's position in the aerospace parts business, an area tipped for future growth. Excluding this deal, overall value was actually up in 2012 relative to 2011.

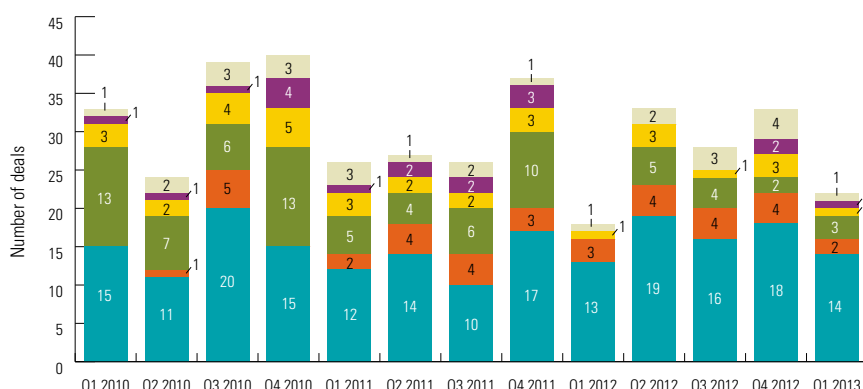
Another encouraging sign of a healthy aerospace, defense and government services sector is the preponderance of large-cap deals. There were 10 deals valued at over US\$500m in 2012, compared to seven in 2011 and only five in 2008.

Despite these favorable trends, the sector shows signs of wear and tear following the global financial downturn. This is particularly evident in mid-market activity: 2012 saw 26 deals under US\$100m, a 32% YoY drop-off and a 55% decline from 2008.

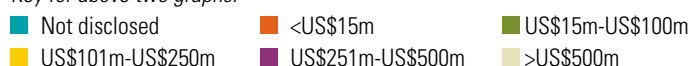
Defense, Aerospace and Government Services Deal Size Splits, Yearly



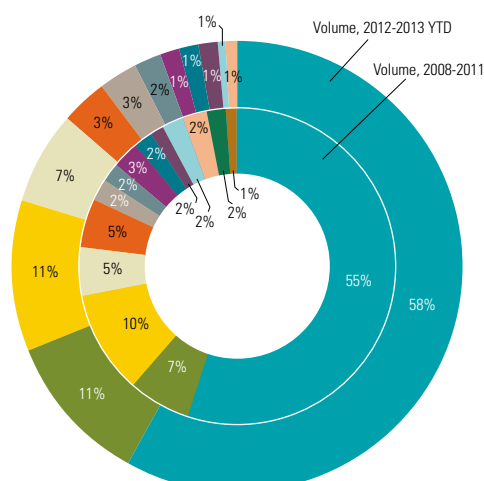
Defense, Aerospace and Government Services Deal Size Splits, Yearly



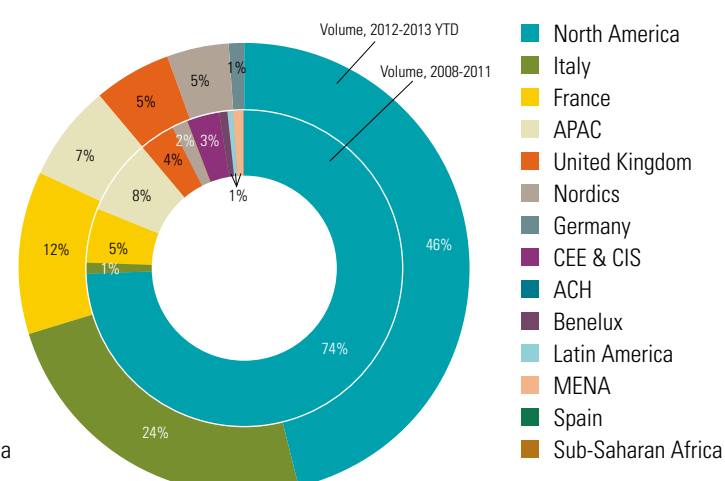
Key for above two graphs:



Defense, Aerospace and Government Services Deal Volume, Split by Region



Defense, Aerospace and Government Services Deal Value, Split by Region



Regional Perspectives

The regional breakdown of aerospace, defense and government services deals has remained consistent over the past five years, with only minor fluctuations. The biggest growth story is APAC's increasing share of overall M&A – a trend still in its infancy. In 2012, there were 10 APAC acquisitions, compared to 2011's three. In early 2013, there have been six transactions with APAC targets. The majority of the recent APAC deals have involved Chinese aerospace companies. The Chinese state wants to tap into China's rapidly increasing appetite for air travel by developing a domestically manufactured jumbo jet to rival the likes of Boeing and Airbus via the state-owned enterprise Commercial Aircraft Corporation of China (COMAC). As Dan Roules, a Shanghai-based partner at Squire Sanders, notes: "This undertaking is driving new business opportunities for aircraft parts companies based around the world."

Even with these developments, the US is far and away the world's biggest spender on defense, with its budget outstripping that of China, the world's second biggest defense spender, four times over in 2012. M&A in the US is especially bound to the defense budget because of the government's policy of domestic procurement. By volume, North America accounts for 58% of deals in the sector over 2012 and 2013 YTD, up from 55% between 2008 and 2011. In absolute terms, dealmaking remained relatively stable with 63 deals in 2011 and 66 in 2012.

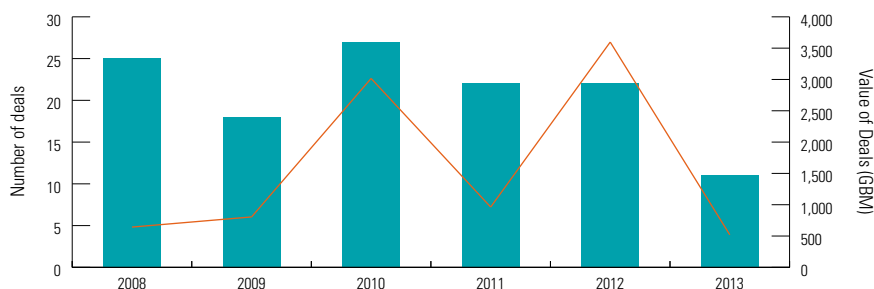
At first blush, North America's share of global aerospace, defense and government services value has told a less positive story, as it shrank 28 percentage points to 46% when comparing 2008-2011 with 2012-2013 YTD. Yet this drop-off mostly relates to 2011's spike from UTC's acquisition of Goodrich.

Private Equity

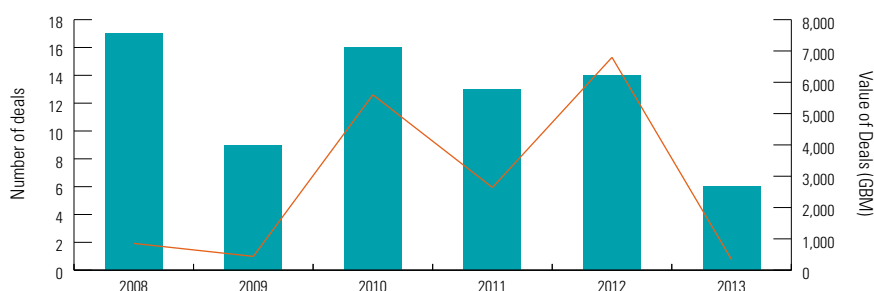
Strategic M&A typically represents the bulk of deal value in the aerospace, defense and government services sector. Last year was thus relatively unique, with private equity players acting as either buyers or sellers in its biggest deals.

New private equity investment was responsible for the second biggest aerospace, defense and government services deal of the year, in which Carlyle Partners and European BC Capital bought out the industrials arm of US-based aerospace

Defense, Aerospace and Government Services Buyout Trends, Yearly



Defense, Aerospace and Government Services Exit Trends, Yearly



Key for above two graphs:

■ Volume — Value (m)

business Hamilton Sundstrand for US\$3.5bn from UTC, with the spun off business re-named Neodyne International. The transaction helped UTC pay for its acquisition of Goodrich and meet regulatory approval. Coming under private equity ownership is set to increase Hamilton Sundstrand's development capabilities and broaden its geographical reach within the US.

This deal is particularly significant, as it marks the first buyout in the sector over US\$1bn since the global financial downturn. On its own, this deal sustained buyout activity for the year, which saw a huge jump in value when comparing 2012 with 2011. There were 22 buyouts in both 2011 and 2012, but buyout value nearly tripled to US\$3.6bn.

In the biggest aerospace, defense and government services deal of the year, a PE firm realized its investment: majority stakeholder, Cinven, a PE firm, and minority stakeholder, Finmeccanica, an industrials conglomerate, sold the aviation arm of Italian aerospace leader Avio for US\$4.4bn. Avio was set to list in 2011, until the deepening of the European sovereign debt crisis. It has subsequently been courted by a number of strategic buyers and financial investors. This deal marked the biggest US direct investment into Italy over the past 10 years. The deal occurred

"The biggest growth story is APAC's increasing share of overall M&A – a trend still in its infancy."

during Mario Monti's tenure as prime minister, which opened up the country to increased foreign investment. To give the transaction scale, the proportion of Italian M&A in the sector by value has risen from 1% in 2008 through 2011 to 24% in 2012 and 2013 YTD, while volume grew only from 2% to 3% over the same periods. This single exit helped to keep exit figures overall robust. While there was only one more exit in 2012 than in 2011 – 14 compared to 13 – deal value increased more than twice over to US\$6.8bn.

While PE activity still represents a minority of the deal activity in the sector overall, PE groups have become increasingly active during the past two years. As Cipriano Beredo, partner at Squire Sanders, notes: "This PE activity is a good sign, particularly since several of the PE transactions are platform acquisitions that will likely lead to "bolt-on" M&A activity and continued growth and expansion."

Aerospace, Defense and Government Services

Sub-Sector Snapshot: Aerospace

Over the past five years, aerospace has dominated the M&A narrative in the overall sector. Over 2008-2011, aerospace deals accounted for 56% of all sector dealmaking. This share has risen slightly to 58% during 2012-2013 YTD. Value has experienced wilder swings, jumping from 65% to 77% of overall industry deal value.

In absolute terms, activity remained flat from 2011 to 2012, which both saw 65 deals. Value dropped 47% to US\$14.4bn over the same period. But it appears that there has been a concentration of higher-value deals in the sector. For instance, while there were 93 deals in 2008, their total value was only US\$10bn.

2012 also saw substantial activity in the sub-sector. Although the would-be game-changing merger of BAE and EADS failed, EADS still generated some of the biggest deals of the year. KfW Bankengruppe, the state-owned German bank, announced plans to buy stakes in the aerospace giant in two transactions, one from a consortium of investors led by Goldman Sachs for US\$1.4bn, and the other from German car manufacturer Daimler for US\$793m. The deal is part of EADS's plans to re-configure its ownership structure, a plan that ultimately seeks to increase the German government's share (via KfW), while the French government reduces its share to be in line with Germany's. These moves are especially significant, as BAE's merger with EADS failed after France, Germany and Britain could not agree on the extent of each other's involvement in the united company.

"In the mid-term, there are formidable hurdles that the aerospace, defense and government services sector will face, especially in relation to defense and government services."

Aerospace faces the challenge of a beleaguered airlines industry in North America and Western Europe. Major airline companies' struggles to remain profitable have been well-publicized, with many of their troubles exacerbated by the rise of budget airliners. Defense spending cuts in the same regions coupled with the winding down of wars in Iraq and Afghanistan means that many companies based in North America and Western Europe will be looking abroad.

Indeed, it seems that commercial aerospace outside of these historic centers of activity will bolster the sector overall. Currently, there is increasing demand from Asia. This upbeat climate has not only been helped by the airline boom but also the growth in the private jet sector. "This is occurring in emerging markets," says Dan Roules, "because there are swathes of increasingly high net worth individuals and businesses that are now able to afford them."

the sequestration in the US is set to slash government spending by US\$85bn, around half of which will be defense cuts. This has impacted M&A in the government services and defense sub-sectors, notes Robert Gregg, partner at Squire Sanders: "Not knowing where the budget will be cut and what programs will be affected has made potential buyers cautious and reluctant to pursue acquisitions unless the valuations are very attractive. There likely are some companies that are ready to sell but not at these depressed valuations. It is unclear whether the budget issues will be resolved in the next six months, so these sellers may have to wait into the next year and hope that valuations go back up."

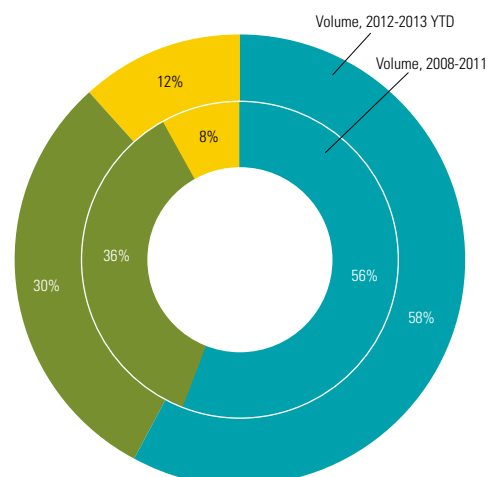
But within this climate, there are opportunities. "Budget cuts mean that the government will have to do more with less, and will likely look to outsource," comments Gregg. While demand for hardware and equipment will probably be heavy-hit, demand for services businesses appears likely to rebound. Changes in government spending may also lead to new pockets of activity. As mismatched valuations have likely dissuaded some strategic buyers, private equity players may play a greater role in the sub-sectors in the coming months.

Further, the sector as a whole, and particularly defense, will get a boost thanks to the

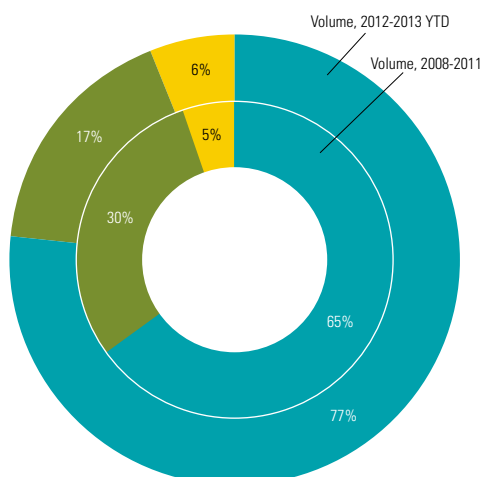
Outlook: Aerospace, Defense and Government Services

In the mid-term, there are formidable hurdles that the aerospace, defense and government services sector will face, especially in relation to defense and government services. For starters,

Defense, Aerospace and Government Services Deal Volume, Split by Sub-Sector



Defense, Aerospace and Government Services Deal Value, Split by Sub-Sector



Key for above two graphs:

- Aerospace
- Defense
- Government services

Top Deals, 2012-2013 YTD

Announced Date	Deal Status	Target Company	Target Sub-Sector	Target Country	Bidder Company	Bidder Country	Seller Company	Seller Country	Deal Value (US\$m)
21/12/2012	P	Avio SpA (aviation business)	Aerospace	Italy	General Electric Company	USA	Cinven Limited; Finmeccanica SpA	United Kingdom	4352
25/07/2012	C	Hamilton Sundstrand Corporation	Aerospace	USA	Carlyle Partners V, LP; BC European Capital IX	United Kingdom	United Technologies Corporation	USA	3460
06/12/2012	P	European Aeronautic Defence and Space Company EADS NV (4.8% stake)	Aerospace	France	KfW Bankengruppe	Germany	Goldman Sachs Group Inc.; Deutsche Bank AG; Allianz SE; Credit Suisse Group AG; Morgan Stanley; Commerzbank AG; Landeskreditbank Baden Württemberg-Förderbank; Sued Beteiligungen GmbH; Sued-Kapitalbeteiligungs-Gesellschaft mbH	Germany	1379
05/07/2012	C	Volvo Aero	Aerospace	Sweden	GKN Plc	United Kingdom	AB Volvo	Sweden	800
06/12/2012	P	European Aeronautic Defence and Space Company EADS NV (2.76% stake)	Aerospace	France	KfW Bankengruppe	Germany	Daimler AG	Germany	793
20/01/2012	C	AmSafe, Inc	Aerospace	USA	TransDigm Group Inc	USA	Berkshire Partners LLC; Alpinvest Partners N.V.; Greenbriar Equity Group LLC	USA	750
12/02/2013	P	Target Logistics Management LLC	Government services	USA	Algeco Scotsman, Inc	USA			625
12/12/2012	P	Pratt & Whitney Power Systems, Inc	Aerospace	USA	Mitsubishi Heavy Industries, Ltd	Japan	United Technologies Corporation	USA	600
12/04/2012	C	Umeco Plc	Aerospace	United Kingdom	Cytec Industries Inc	USA			556
23/07/2012	P	Pratt & Whitney Rocketdyne Inc	Defense	USA	GenCorp Inc	USA	United Technologies Corporation	USA	550

C = Complete; P = Pending

changes in US export control laws. The current and planned movement of military items from the International Traffic in Arms Regulations (ITAR) to the Export Administration Regulations (beginning in October 2013 and continuing through 2014) is the most significant change in US export controls in 50 years. Over the past 10 to 15 years, non-US customers have increasingly considered using "ITAR-free" content in their systems to avoid the application of the ITAR to non-US systems. ITAR has had a direct impact on M&A in the space, and has even increased the time it takes to complete deals. According to George Grammas, regulatory partner at Squire Sanders: "This policy does not foster interoperability and cooperation among the US's closest allies, and has led to a less integrated industry." The Obama administration's proposed changes to strengthen controls on the most important technologies also result in lesser controls over less sensitive products, particularly in areas of parts, components and certain systems and subsystems, which are essential to crossborder trade. "This has been an important year in US export controls as it will reduce ITAR problems and foster greater cooperation and competition," adds Grammas.

On the commercial aerospace side, the picture is rosier. "Record order books and a significant backlog for commercial aircraft manufacturers indicate that we are at the middle of an extended growth cycle, not the end," says Cipriano Beredo.

"Fuel prices, along with the timing and success of new aircraft product introductions, will undoubtedly impact the pace and magnitude of this expansion. But we expect that the core drivers of the growth cycle – airlines shifting to more advanced and fuel-efficient aircraft

"Activity in MENA, particularly in Saudi Arabia, is also generating a great deal of enthusiasm in the sector."

and building their fleets to meet demand in emerging markets – will continue to drive M&A, particularly for component manufacturing companies."

While these historic hotspots for aerospace, defense and government services M&A are remaining steady, it appears that the center of gravity is beginning to shift elsewhere, particularly to the Asia-Pacific and the Middle East and North Africa (MENA). China's defense spending has increased exponentially over the past two decades. While this jump has yet to lead to a substantial increase in M&A, and is currently often taking the form of joint ventures between foreign and Chinese companies, it appears inevitable that it will do in the future. Activity in MENA, particularly in Saudi Arabia,

is also generating a great deal of enthusiasm in the sector. Saudi Arabia has dramatically increased its defense budget in recent years, accounting for 8.9% of GDP in 2013. "This move comes in response to internal and external threats. There is also little local manufacturing, providing ample opportunities for foreign businesses in the country," says Ziad El-Khoury, partner at Squire Sanders. This increased budget is generating activity for a range of businesses. There has been an increase in security spending in areas such as border control and oil field protection, in addition to traditional defense products. Despite the robust climate, foreign direct investment into the country remains limited, with those from abroad typically setting up original equipment manufacturers to gain a foothold in the country. "While M&A in Saudi Arabia remains limited, the increase in defense spending will likely contribute to dealmaking abroad, when companies, likely those that are incorporated elsewhere but that are active in Saudi Arabia, combine," comments El-Khoury.

The sector has several characteristics that will help drive M&A in the future. Innovation is an integral part of remaining competitive for many businesses that turn to inorganic growth to quickly come up-to-speed with new technologies. And, although it failed, the BAE and EADS merger showed the potential for transformative acquisitions. While the sector may experience growing pains in the near future, there looks to be space for M&A in it.

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Our Aerospace & Defense Industry Group represents contractors at all tiers in aerospace, defense, homeland security, intelligence and government services. Our clients include more than one third of the top 100 contractors as well as many smaller and lower tiered contractors.

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In brief, we help our clients to complete successful M&A transactions.

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