



Aerospace / Defense & Government Services 2019 M&A Survey - SPECIAL REPORT



KippsDeSanto is pleased to share its second annual survey of mergers and acquisitions (M&A) activity and sentiment in the Aerospace / Defense and Government Services sectors.

In this study, we asked key dealmakers from relevant sectors to share their predictions about M&A deal activity and valuations over the next year. We also asked them to share their insights on strategic drivers of M&A activity and the impact of recent events, including the 2018 United States midterm elections.

In our [previous survey](#) that focused on predictions for 2018, we found dealmakers were very optimistic about the overall economy and M&A activity. They expected strong to moderate overall economic growth and increased M&A activity and valuations, due in large part to the 2017 tax law changes and greater budget visibility.

In this follow-up survey, which assesses predictions for 2019, we find dealmakers remain quite positive about 2019, with most expecting moderate economic growth and predicting M&A activity will increase somewhat or remain about the same as 2018. These are quite positive findings, given the relative economic high point of the past year.

Overall, 222 dealmakers who are interested in the Aerospace / Defense and Government Services sectors participated in the survey. This includes 122 CEOs, presidents, CFOs, corporate development executives, or other executive level respondents from corporate / strategic buyers, and 77 partners and senior professionals from private equity groups — including most of the largest and most active industry buyers. Just over 60% of respondents are strategic buyers and 35% are from private equity groups. See Page 16 for more details on survey respondents.



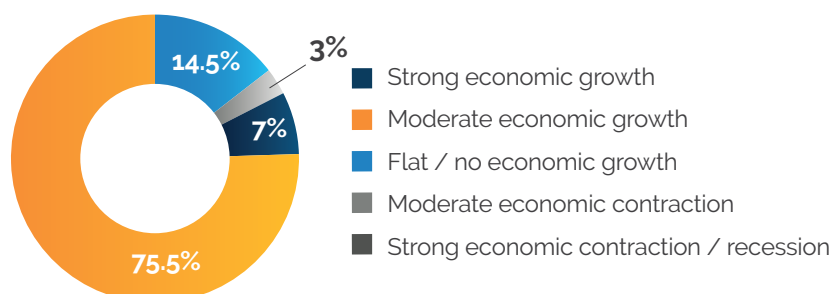
“We have witnessed strong M&A activity in the Aerospace / Defense and Government Services sectors over the past five years, totaling over 300 transactions annually during this period. As the largest independent investment bank focused exclusively on these sectors, we have a unique position to understand the dynamics driving this volume of activity. Through this report, we hope to present the market with a broader view of the underlying factors that drive the decision-making of dealmakers in these sectors. This includes potential drivers of continued momentum of M&A activity in Aerospace / Defense and Government Services sectors in 2019.”

– BOB KIPPS, MANAGING DIRECTOR, KIPPSDESANTO & CO.

Dealmakers Predict Moderate Economic Growth

Overall, dealmakers remain quite positive about the overall economy, with 75% expecting moderate economic growth in 2019 and 7% expecting strong growth. The number of respondents predicting no economic growth or slight contraction increased compared to 2018, with 14.5% predicting no economic growth in 2019 and 3% predicting moderate contraction. These results are slightly less optimistic than last year, when over a quarter of respondents expected strong economic growth and no respondents expected economic contraction.

Expectations for the U.S. Economy in 2019

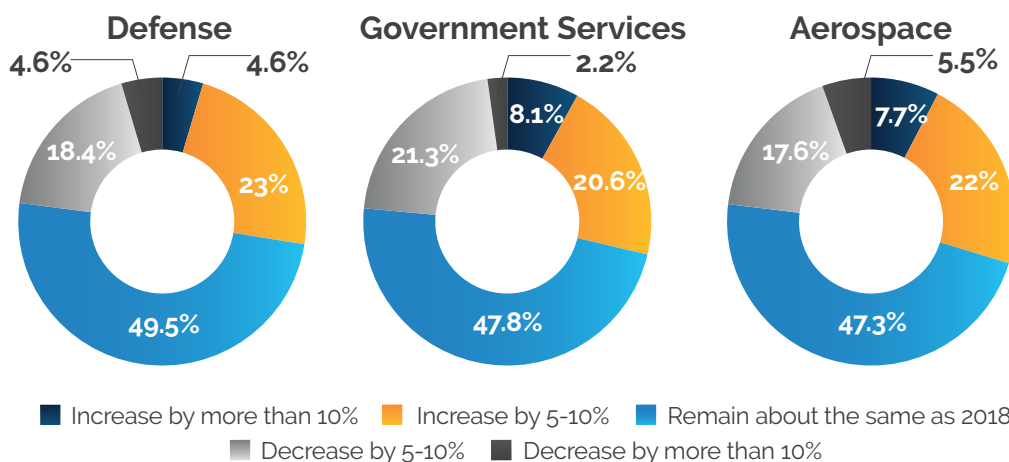


IN RESPONSE TO: Which of the following best describes your expectation for U.S. economic growth in 2019?

M&A Activity Expected to Increase Slightly or Remain the Same in Aerospace, Defense and Government Services Sectors

Nearly 50% of respondents in each sector expect M&A to remain as active in 2019 as 2018, while approximately 28% expect activity to increase by 5% or more. While slightly less optimistic than dealmakers' predictions for 2018, it shows continued, if more tempered, optimism about activity levels in each sector.

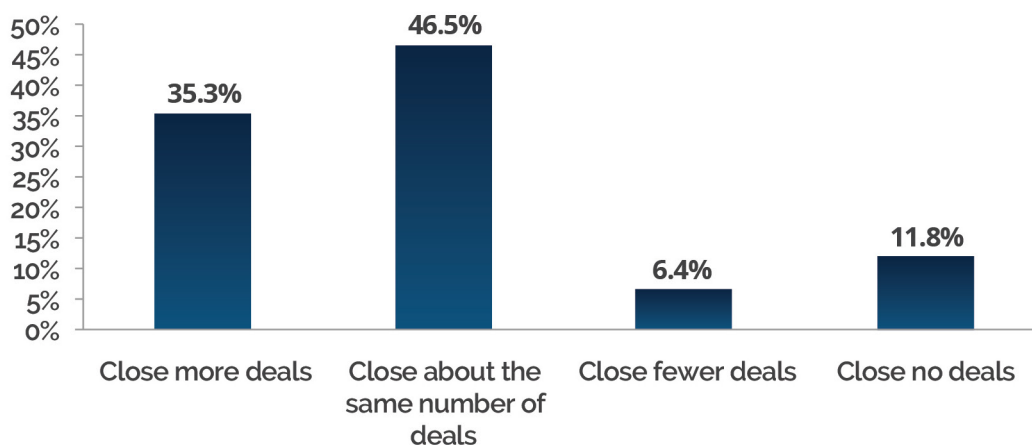
M&A Activity in 2019 vs. 2018 by Sector



IN RESPONSE TO: In your opinion, how will overall M&A activity in 2019 compare to 2018 in each sector?
The number of deals closed in 2019 will ...

Across all sectors, 47% of dealmakers expect to close the same number of deals in 2019 as they did in 2018, while 35% expect to close more deals. In 2018, 50% of dealmakers expected to close more deals and 38% expected to close the same number of deals as the previous year. This year, the number of respondents expecting to close fewer or no deals remains the same as in 2018. Given 2018's activity levels, these results suggest M&A activity levels will remain high in 2019.

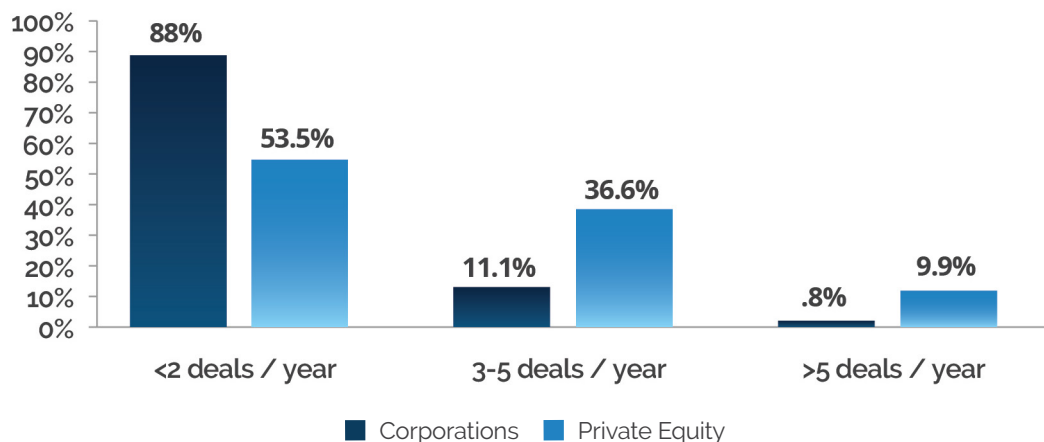
M&A Deals at Dealmaker's Own Organization



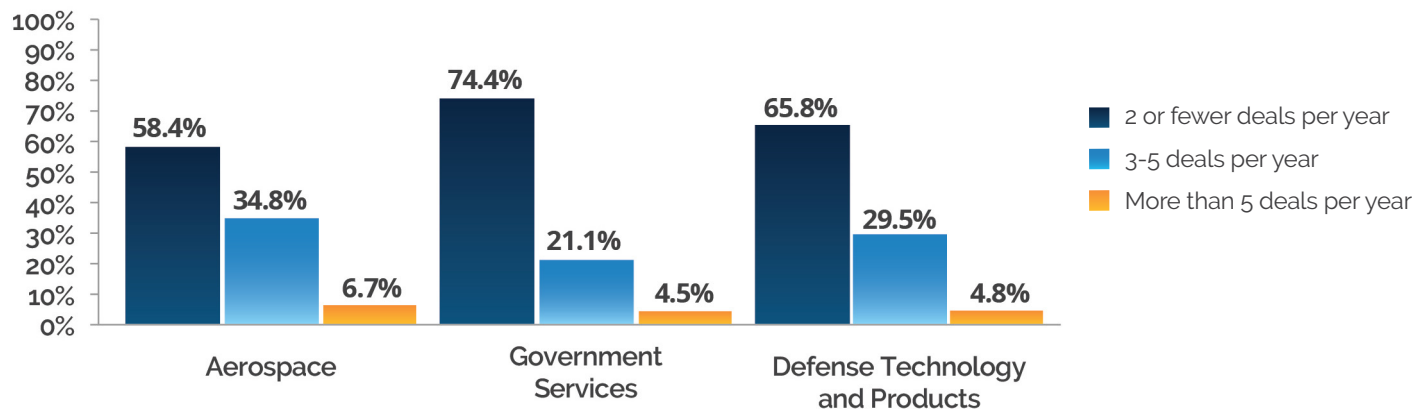
IN RESPONSE TO: *How active will your organization be in M&A in 2019 compared to 2018? We expect to ...*

We also asked dealmakers how many deals they typically close in a year. Not surprisingly, private equity respondents tend to close slightly more deals than strategic buyers. Among corporate respondents, 88% close fewer than two deals per year and just 12% close three or more deals. Approximately 47% of private equity respondents close three or more deals per year, while 53% close two or fewer deals. Among both corporate and private equity respondents, those interested in the Aerospace sector are significantly more likely to close three to five deals per year than those interested in Government Services or Defense sectors.

Average Number of Deals Closed Per Year (Corporate vs. Private Equity)



Average Number of Deals Closed Per Year (By Sectors of Interest)

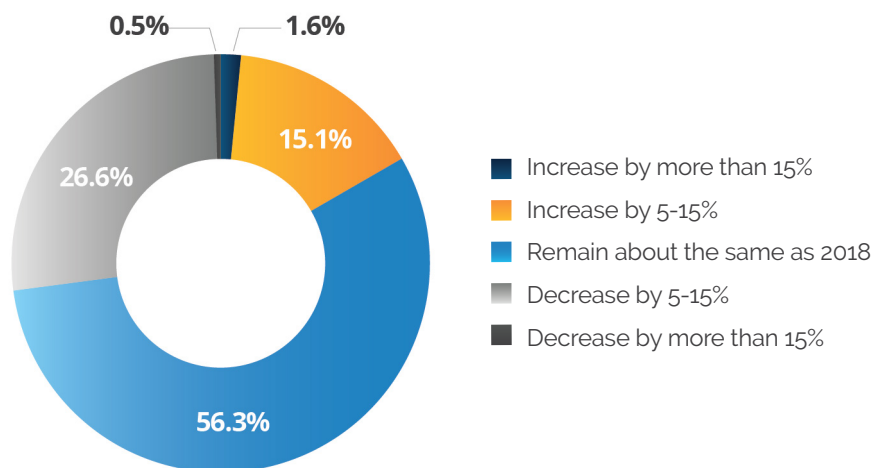


IN RESPONSE TO: *How many M&A deals does your organization close in a year?*

Majority of Dealmakers Expect Stable Valuations in 2019

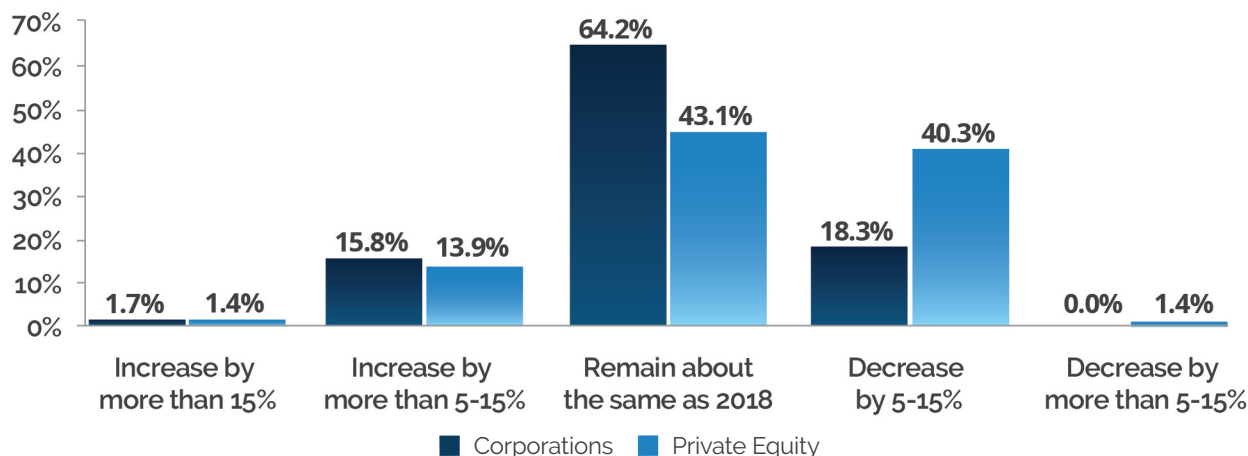
Looking forward to 2019, 56% of respondents expect deal valuations to remain the same as 2018's levels, up from 50% who made this prediction in our 2018 survey. Of those expecting a meaningful change, more respondents expect valuations to decrease than to increase, the reverse of last year's survey. In 2019, only 17% of respondents expect deal valuation to increase compared with 48% who expected an increase in 2018, while 27% expect deal valuations to decrease in 2019 compared with just 3.1% who expected a decrease in 2018. This is not surprising given the stock market volatility during the second half of 2018.

Valuation Predictions



Interestingly, dealmakers at private equity firms are significantly more likely to predict that deal valuations will decrease in 2019 than are corporate respondents.

Valuation Predictions (Corporate vs. Private Equity)

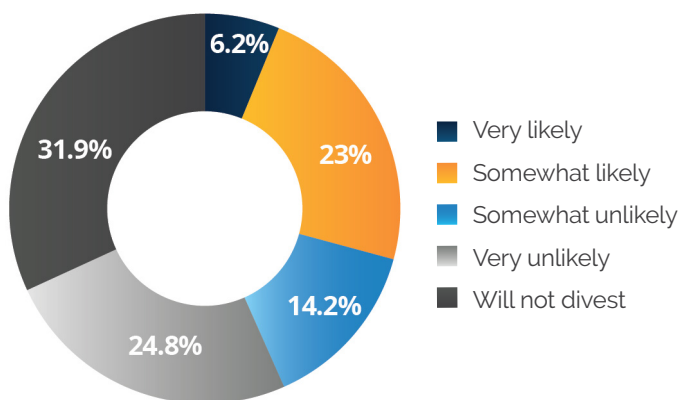


IN RESPONSE TO: How will the overall valuations of U.S.-based M&A targets in 2019 compare to 2018?

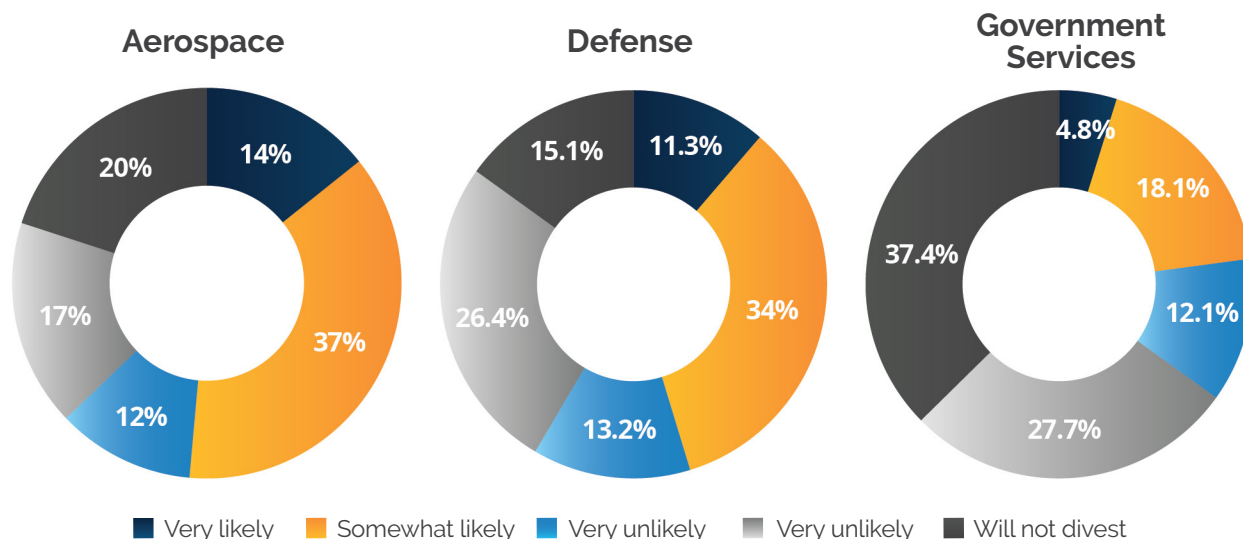
Divestitures Predictions Remain Mixed Across Sectors

We asked corporate dealmakers how likely they are to divest of any units or operations over the next 12 months. Overall, respondents remain unlikely to divest. Approximately 70% of respondents say they are somewhat or very unlikely to or will not divest, while just 29% say they are somewhat or very likely to divest. As in 2018, respondents interested in the Government Services sector are significantly less likely to divest than those interested in aerospace or defense. About 65% of those interested in government services say they are very unlikely to or will not divest compared to 42% of respondents interested in defense and 37% interested in aerospace.

Likelihood of Divesting Units or Operations in Next 12 Months (All Sectors)



Likelihood of Divesting (By Sectors of Interest)

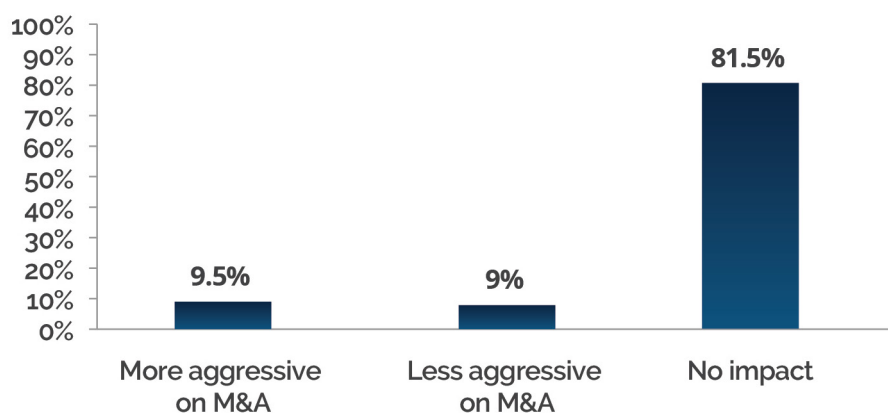


IN RESPONSE TO: How likely is your company to divest any operations or units within the next 12 months?

Impacts of Political Changes on M&A Activity

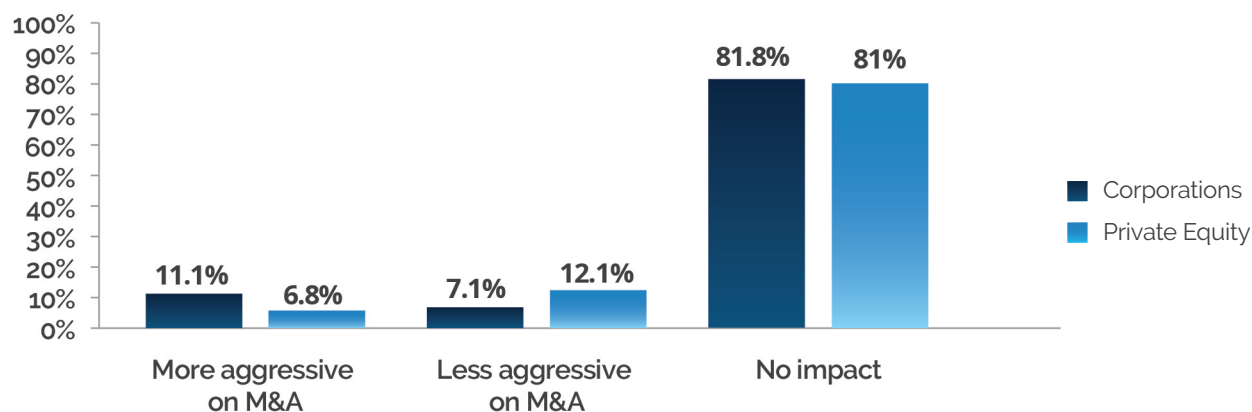
We asked dealmakers if the 2018 U.S. midterm election results are impacting their M&A strategy for 2019. Over 80% of respondents say the midterm results will have no impact. Interestingly, respondents who say the midterms will impact their M&A strategy are about equally split on if the elections will make them more or less aggressive.

Impact of 2018 U.S. Midterm Elections on M&A Strategy (All Respondents)

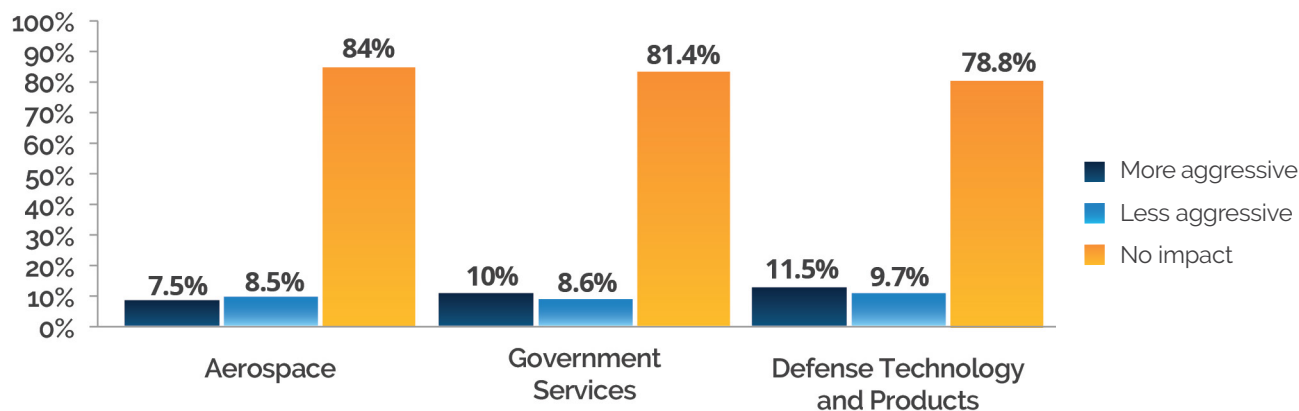


There are, however, some small differences in responses between respondents from corporate versus private equity organizations and respondents with different sectors of interest. Respondents from private equity organizations are slightly more likely to be **less aggressive** on M&A due to the midterms, while corporate representatives are slightly more likely to be **more aggressive** on M&A. Similarly, respondents interested in aerospace are slightly more likely to be **less aggressive** on M&A in response to the midterms, while respondents interested Defense and Government Services sectors are slightly more likely to be **more aggressive** on M&A.

Impact of 2018 U.S. Midterm Elections on M&A Strategy (Corporate vs. Private Equity)



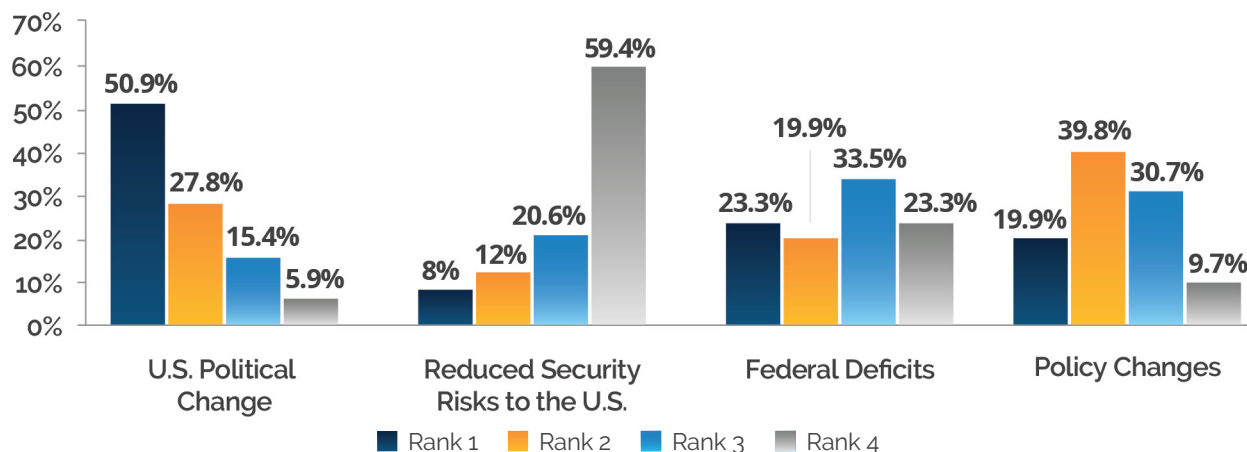
Impact of 2018 U.S. Midterm Elections on M&A Strategy (By Sectors of Interest)



IN RESPONSE TO: What impact will the recent U.S. midterm elections have on your M&A strategy in 2019 and beyond? We will be ...

While the midterm elections had limited impact on predictions about M&A strategy, respondents note that political changes may have a negative impact in the M&A arena. We asked dealmakers to rank four possible risks to overall budgets and growth prospects from most to least important. U.S. political changes and policy changes are the clear first and second highest rated risks. Federal deficits rank as third most important and reduced security risks to the U.S. rank as least important.

Risks to Budgets and Growth Prospects

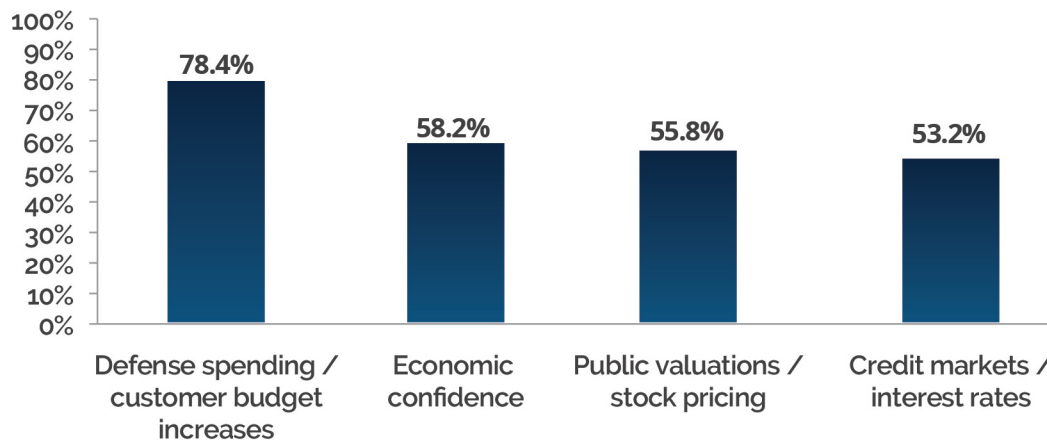


IN RESPONSE TO: Rank the following based on which you think present the biggest overall risks to budgets and growth prospects, 1 = biggest risk and 4 = smallest risk

M&A Momentum Drivers

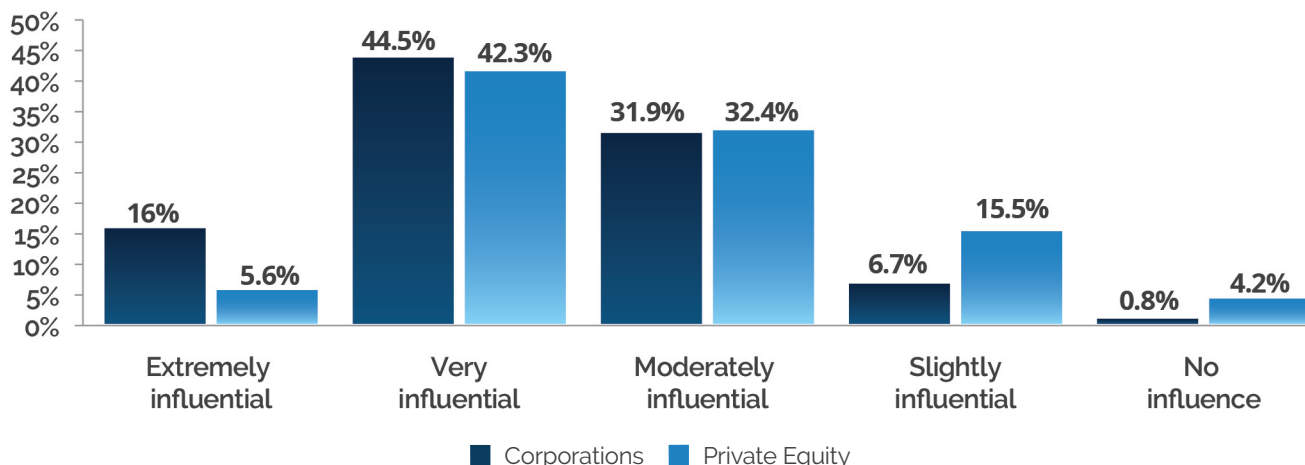
Defense spending continues to be the most important factor influencing overall deal activity and target valuations in the U.S., with nearly 80% of all respondents saying it is extremely or very influential. Economic confidence, public valuations / stock pricing, and credit markets / interest rates are all similar in importance, with between 53% and 58% of respondents saying they are extremely or very influential in deal activity and valuations.

Drivers of M&A Momentum (% saying factor is extremely or very influential)



Corporate respondents are significantly more likely to say that public valuations / stock pricing is extremely influential to deal activity levels and target valuations than private equity respondents.

Importance of Public Valuations / Stock Pricing in Overall Deal Activity and Target Valuations

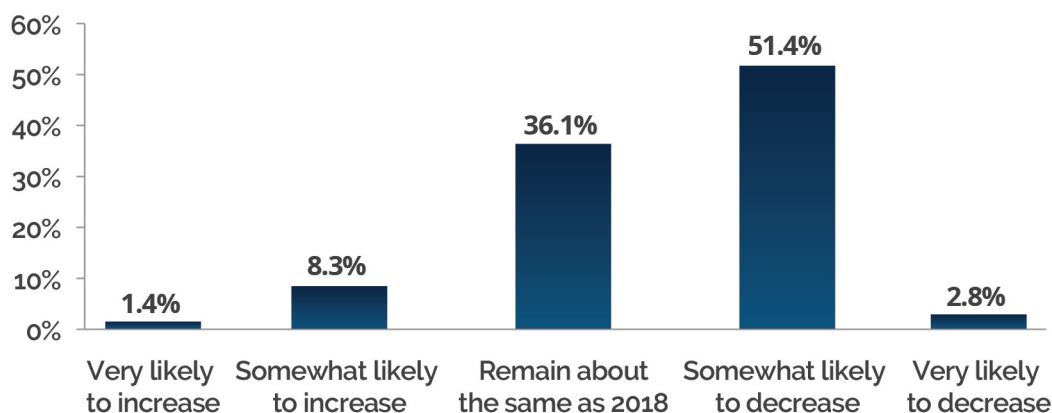


IN RESPONSE TO: Rate the following factors based on how much influence they have on overall deal activity and target valuations in the U.S.

2019's Credit Market

We asked private equity dealmakers for their predictions about the credit market in 2019 given its influence on deal activity levels and valuations. They are less optimistic about debt leverage / availability in 2019 than they were in 2018. Perhaps as a result of 2018's capital market volatility, just over 54% of private equity respondents expect debt leverage / availability to decrease compared to 2018; 36% expect it to remain the same; and 10% expect it to increase. This is the reverse of 2018, when 50% of respondents expected it to remain the same and 30% expected it to increase.

Debt Leverage / Availability in 2019 vs. 2018

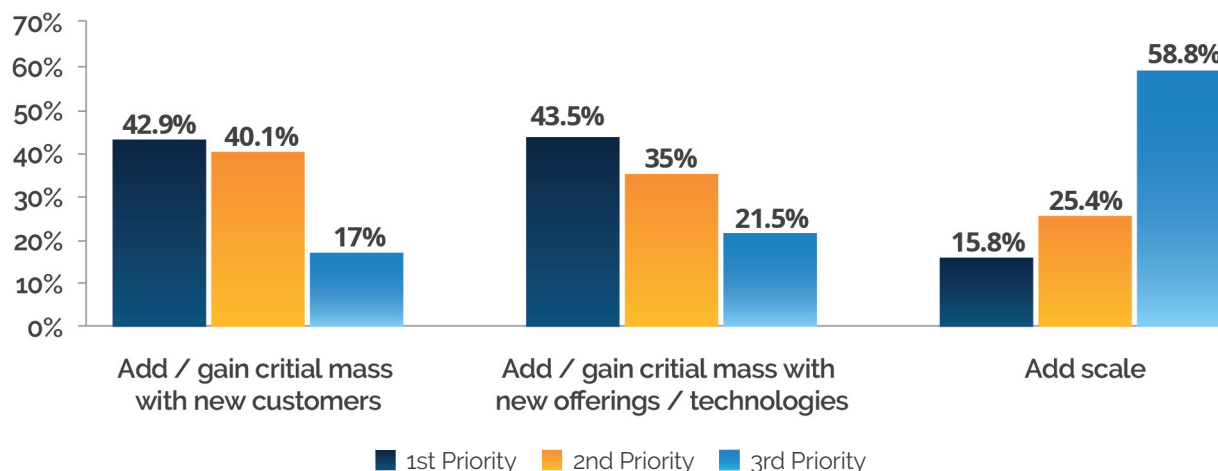


IN RESPONSE TO: How do you expect debt / leverage availability to change in 2019 compared to 2018 for your transactions? (asked of private equity only)

Main M&A Buyer Goals

When asked to rank their top M&A goals, adding critical mass with new customers (83%) and adding new offerings / technologies (79%) continue to be the top priorities of M&A. Adding scale continues to be a third priority.

M&A Strategy Goals



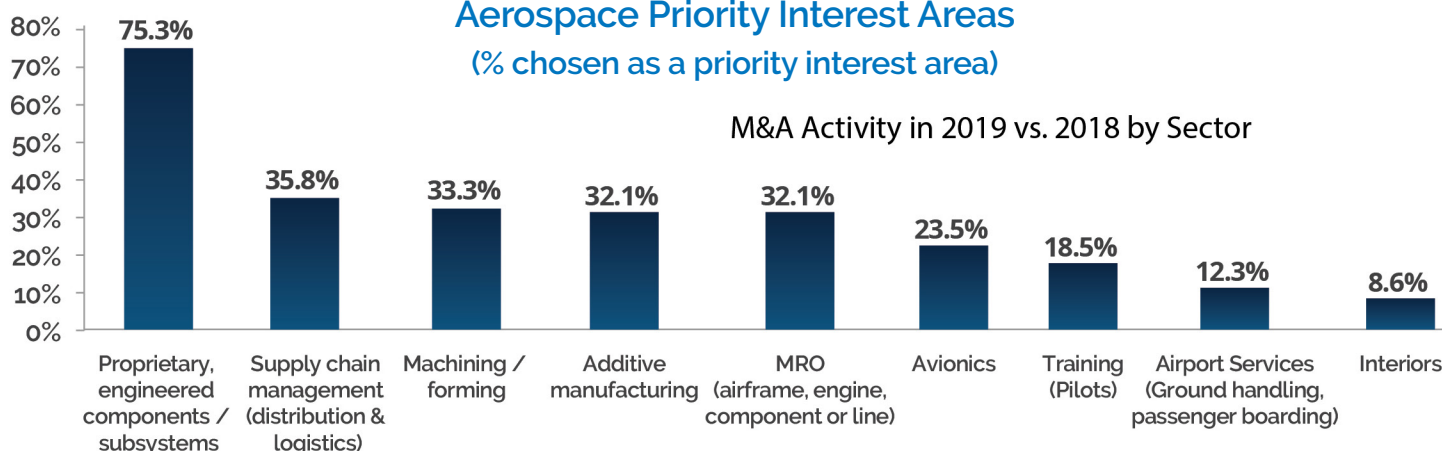
IN RESPONSE TO: Please rank how important the following goals are in your organization's M&A strategy.

Top M&A Interest Areas by Industry Sector

In the **Aerospace sector**, the top priority area for M&A activity remains the same as in 2018: Proprietary, Engineered Components / Subsystems is named as a top priority by 75% of respondents. However, respondents' prioritization of other target areas shifted since 2018. MRO (airframe, engine, component or line) and Avionics are no longer in the top four priority areas, replaced by Machining / Forming and Additive Manufacturing chosen as top priorities by 33% and 32% of respondents respectively. Supply Chain Management remains one of the top four priority areas chosen as a top priority by 36% of respondents.

Aerospace Priority Interest Areas (% chosen as a priority interest area)

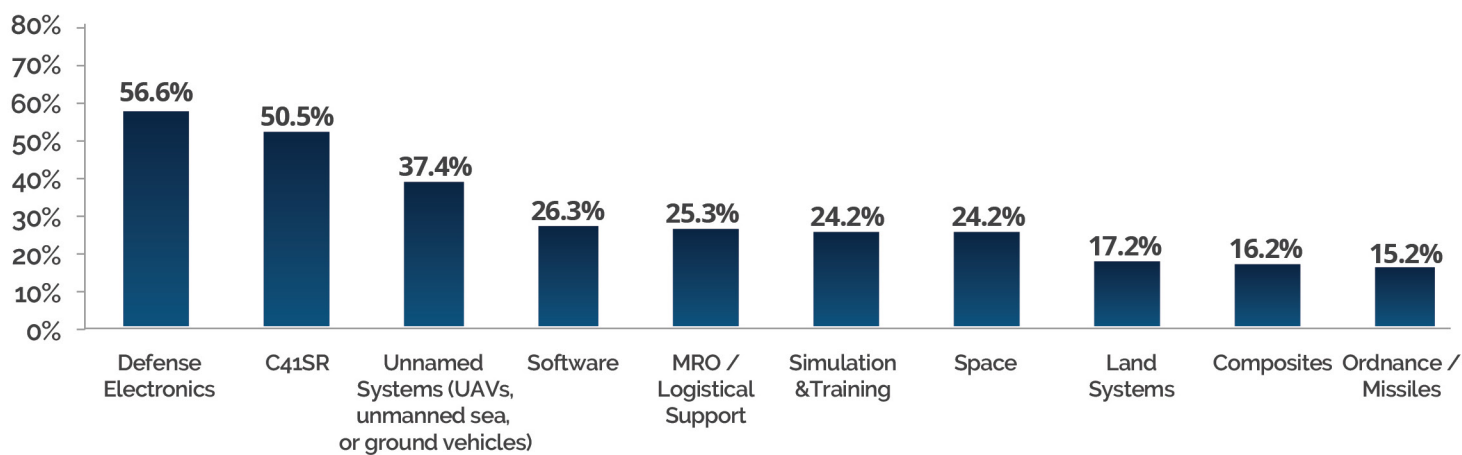
M&A Activity in 2019 vs. 2018 by Sector



IN RESPONSE TO: Based on the following list, choose and rank which M&A target areas are the top three priorities for your organization in the Aerospace sector over the next 12 to 24 months. You may only choose and rank three target areas.

In the **Defense sector**, the top three priority M&A interest areas remain the same as 2018: Defense Electronics, C4ISR and Unmanned Systems are again chosen as top priorities by the largest percentage of respondents (57%, 51% and 34%, respectively). For 2019, software is the fourth most chosen priority area (chosen by 24% of respondents) pushing Simulation and Training out of the top four. However, Software, MRO / Logistical Support, Simulation and Training, and Space are chosen as priority areas by a similar percentage of respondents (24% to 26% each).

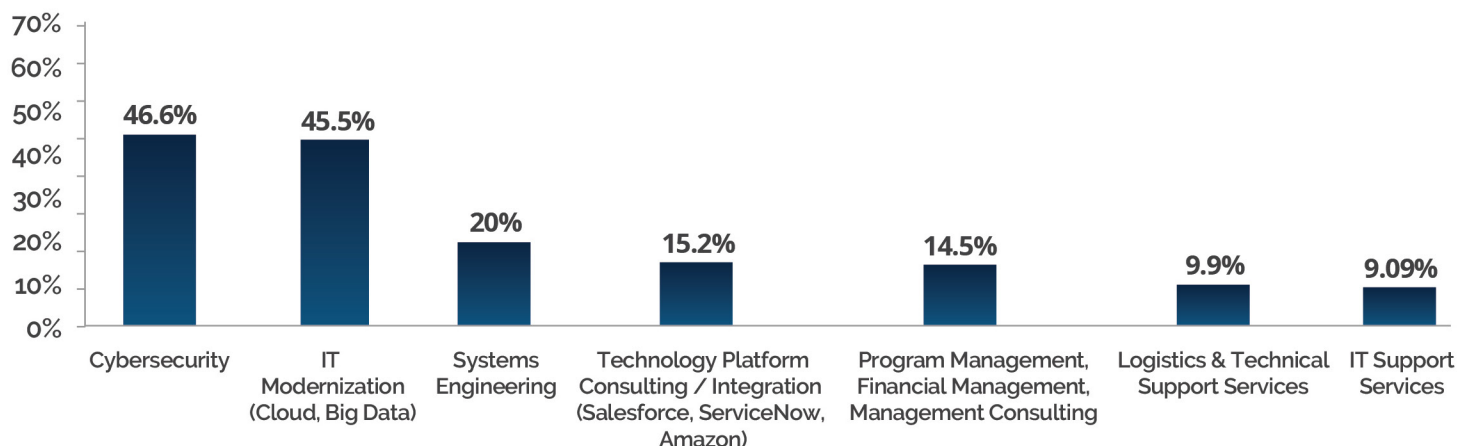
Defense Priority Interest Areas (% chosen as a priority interest area)



IN RESPONSE TO: Based on the following list, choose and rank which M&A target areas are the top three priorities for your organization in the Defense Technology and Products sector over the next 12 to 24 months. You may only choose and rank three target areas.

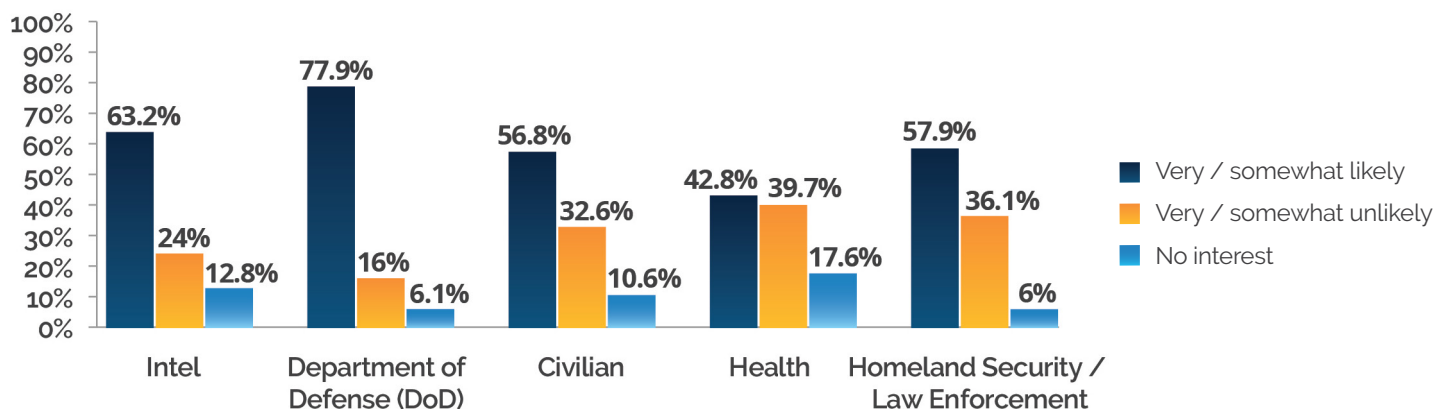
In the **Government Services sector**, Cybersecurity and IT modernization are the clear first priorities, followed by Systems Engineering. The same as in our 2018 survey.

Government Services Priority Areas (% chosen as a top priority interest area)



We also asked respondents interested in government services how likely they are to seek targets in a range of key end markets. Department of Defense is the most popular, with nearly 80% of respondents very or somewhat likely to seek targets in this end market in 2019. Interestingly, private equity dealmakers are significantly more interested in all end markets than corporate respondents.

Priority End Markets for the Government Services Sector

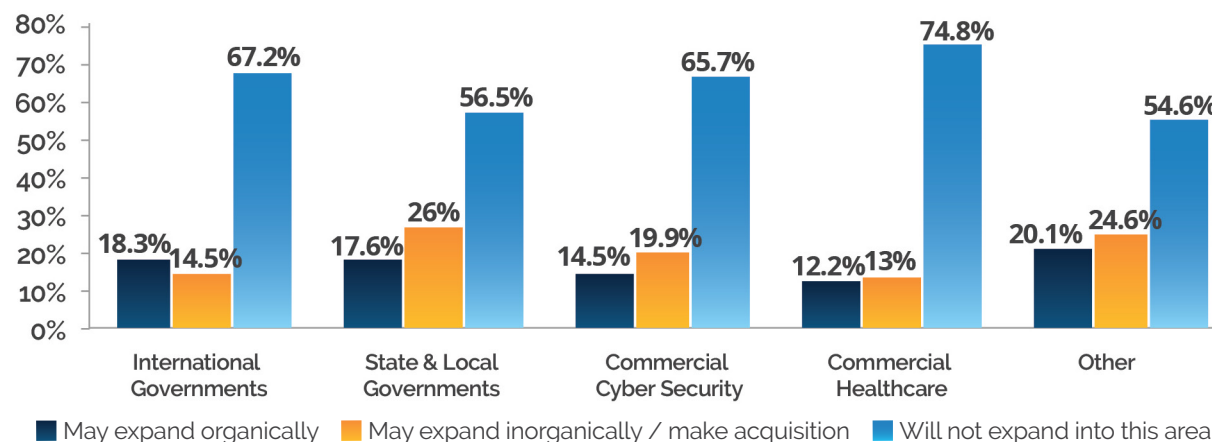


IN RESPONSE TO: How likely are you to seek U.S.-based targets in the following end markets over the next 12 to 24 months? (Asked of respondents interested in government services only)

Most Dealmakers Not Considering Expansions into Non-U.S. Government Areas

We asked dealmakers interested in the Government Services sector if they are considering expanding into any non-U.S. government areas. The majority of respondents are not considering this type of expansion, with between 55% and 78% saying they will not expand, depending on the area. Of respondents who are considering expanding, more are considering expanding by acquisition than by organic growth in all areas except international governments.

Interest in Expanding to Non-U.S. Government Areas

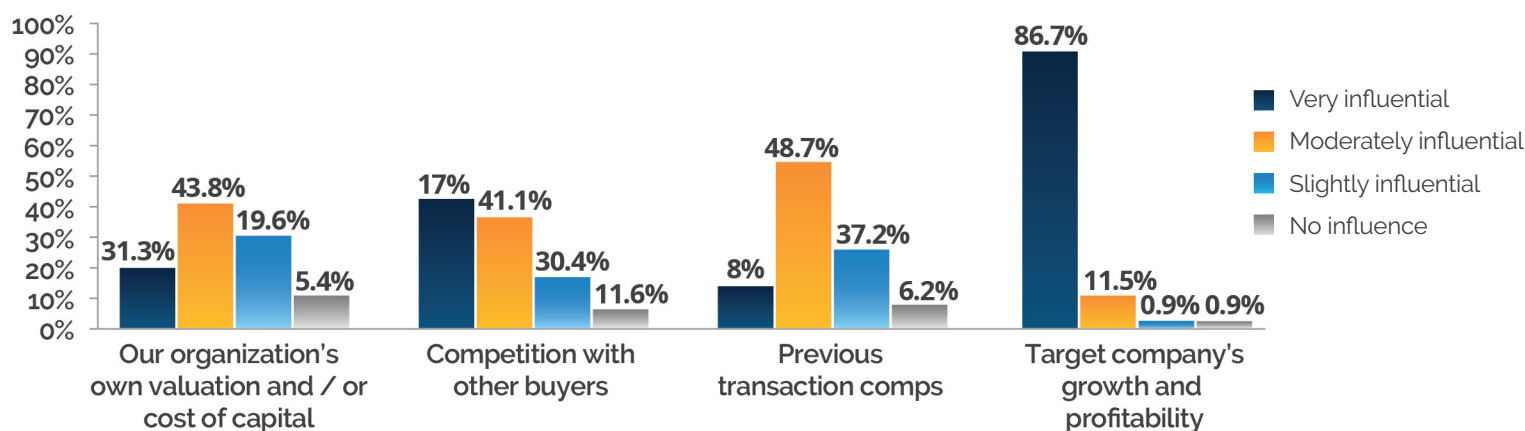


IN RESPONSE TO: Is your firm considering expanding organically or inorganically into any of the following non-U.S. government areas?

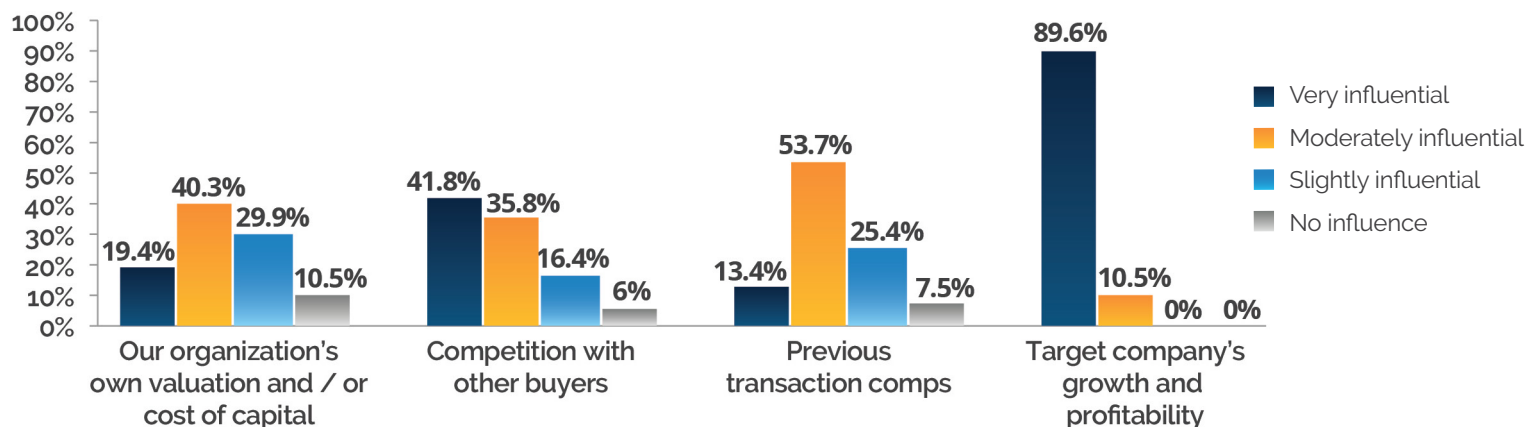
Factors Influencing Target Valuations

We asked dealmakers to assess some key factors that may influence their valuations of potential targets. Over 85% of corporate and private equity respondents say the target company's growth and profitability is very influential in target valuations. For corporate respondents, their organization's own valuation and / or cost of capital is the second most influential factor, rated as very or somewhat influential by 75% of respondents. For private equity respondents, competition with other buyers is the second most influential factor, rated as somewhat or very influential by 77% of respondents.

Factors Influencing Target Valuations (Corporate Respondents)



Factors Influencing Target Valuations (Private Equity Respondents)



IN RESPONSE TO: How much influence do each of the following factors have in your valuation of potential U.S.-based targets?

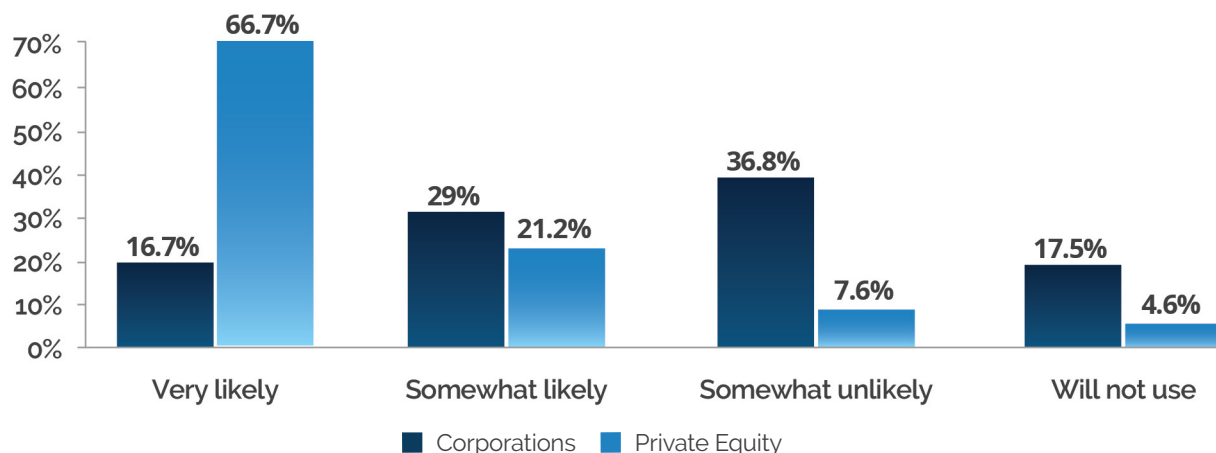
M&A Dealmaking Process Insights

We asked a range of questions to assess respondents' preferences and processes for the dealmaking process including their plans to use representations and warranties insurance; issues causing deal failures; and the optimal length for a deal process. Dealmakers' answers contain some interesting differences from our 2018 survey.

Private Equity Organizations Continue to Expand Use of RWI

Private equity respondents continue to be more likely than corporates to use Representations and Warranties Insurance (RWI). Approximately 88% of dealmakers from private equity firms are very or somewhat likely to use RWI, up from 85% in 2018. And, 46% of corporate respondents are very or somewhat likely to use RWI.

Use of Representations and Warranties Insurance (Corporate vs. Private Equity)

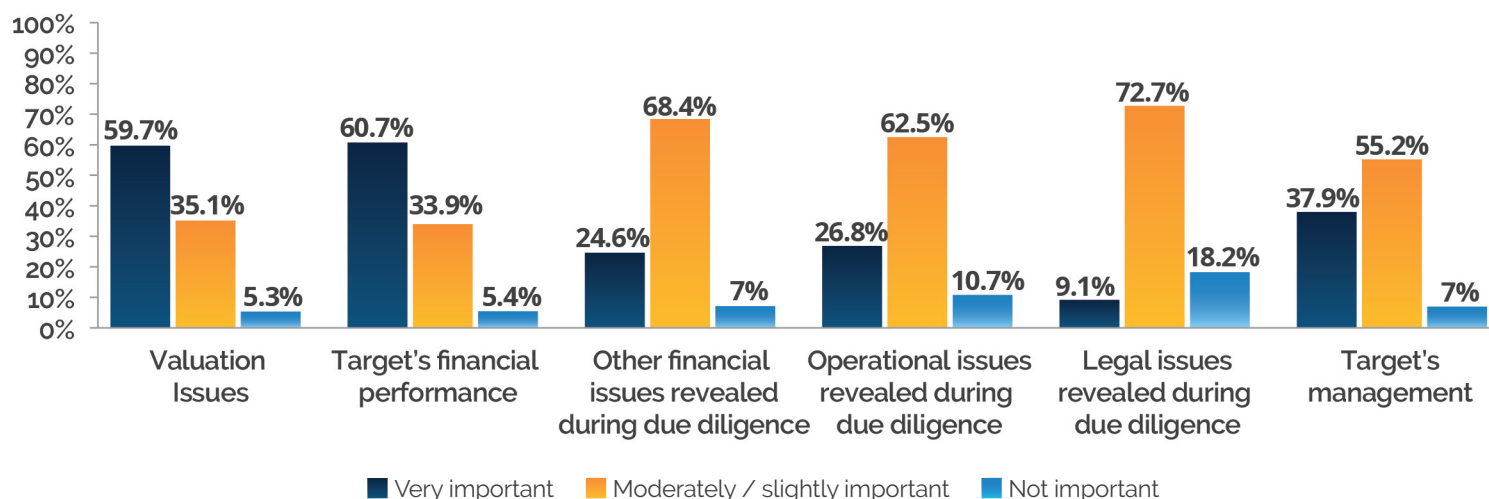


IN RESPONSE TO: *How likely are you to use Representations and Warranties Insurance in 2019?*

Financial Performance and Valuation Issues Remain Most Important Reasons for Deal Failures

We asked dealmakers to share insights into why later stage, exclusive deals end up falling apart. Valuation issues and the target's financial performance are again rated as the most important factors in deal failure; each chosen as very important by 60% of respondents. The target's management is the third most important factor, chosen as very important by nearly 40% of respondents and moderately / slightly important by 55% of respondents.

Deal Failure Factors

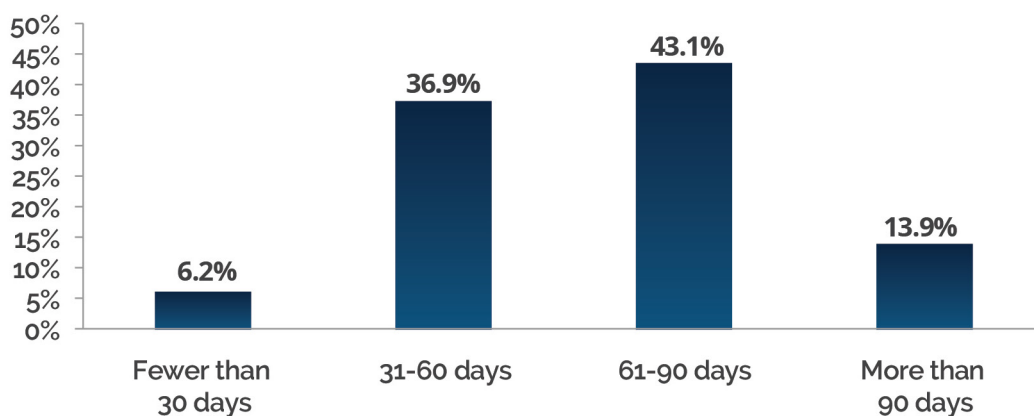


IN RESPONSE TO: In 2018, if your organization had exclusive, later stage discussions with a potential target that did not close, how important were each of the following as reasons the deal(s) failed?

Preferred Deal Closure Timeline

As in 2018, we asked private equity respondents to share the average amount of time it takes from gaining exclusivity on a deal to signing definitive deal documentation. Interestingly, average time to signing definitive deal documentation increased compared to our previous survey. Over 43% of respondents say the average time from exclusivity to signing deal documentation is 61 to 90 days, an increase from 36% saying this in the previous survey. About 14% say the average time is more than 90 days compared to just 7.6% in the previous survey. While only 6% say the average time is fewer than 30 days compared to 23% in the previous survey.

Average Time from Gaining Exclusivity to Signing Definitive Documentation



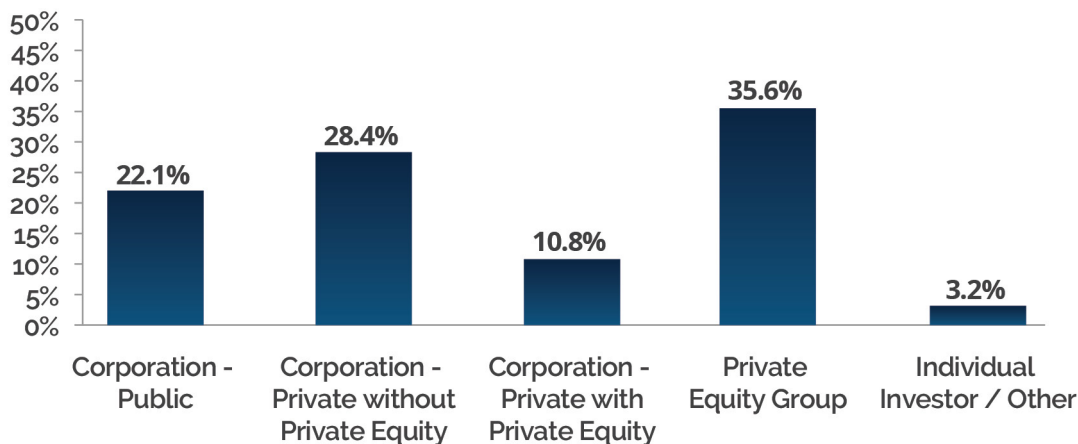
IN RESPONSE TO: In recent deals where you gained exclusivity, what was the average amount of time from the granting of exclusivity to the signing of definitive deal documentation? (asked of private equity respondents only)

Survey Results Based on Key Buyer Representatives

Overall, 222 dealmakers who are interested in the Aerospace, Defense and Government Service sectors participated in the survey, including a majority of the most active industry buyers.

Approximately 60% of respondents work for corporations, and about 46% of these work for public companies. The remainder work for private corporations.

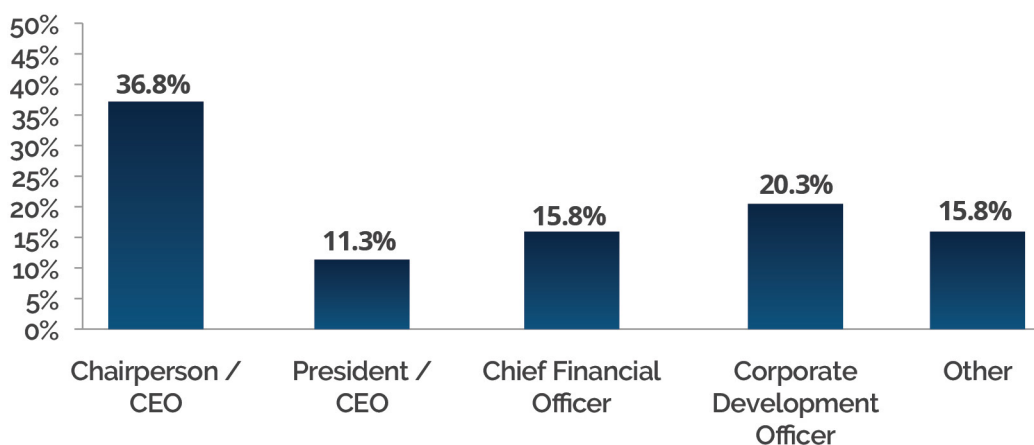
Respondents' Organization Type



IN RESPONSE TO: *Do you work for a corporation / strategic buyer or private equity group?*

Among corporate respondents, 36% are CEOs or chairpersons, 20% are corporate development officers, and about 27% are COOs or CFOs.

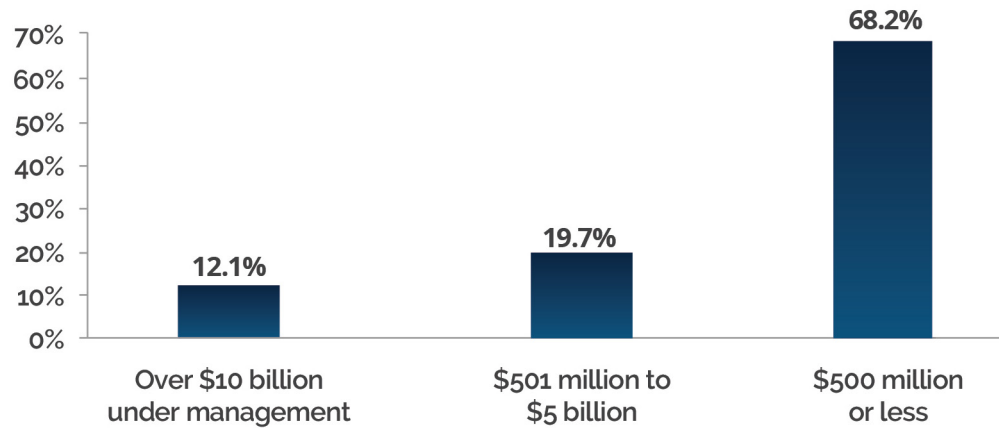
Title / Role (Corporate Respondents)



IN RESPONSE TO: *What is your title / role within your organization?*

Approximately 12% of corporate respondents had more than \$5 billion in revenue in 2018. Another 20% of corporate respondents had more than \$500 million in revenue in 2018.

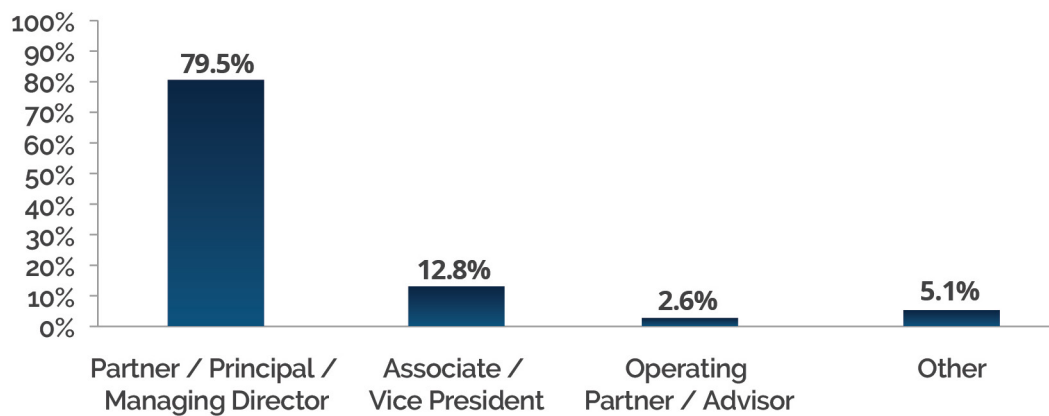
Revenue in 2018 (Corporate Respondents)



IN RESPONSE TO: *What was your company's revenue in 2018?*

Nearly 80% of private equity respondents are partners, principals or managing directors.

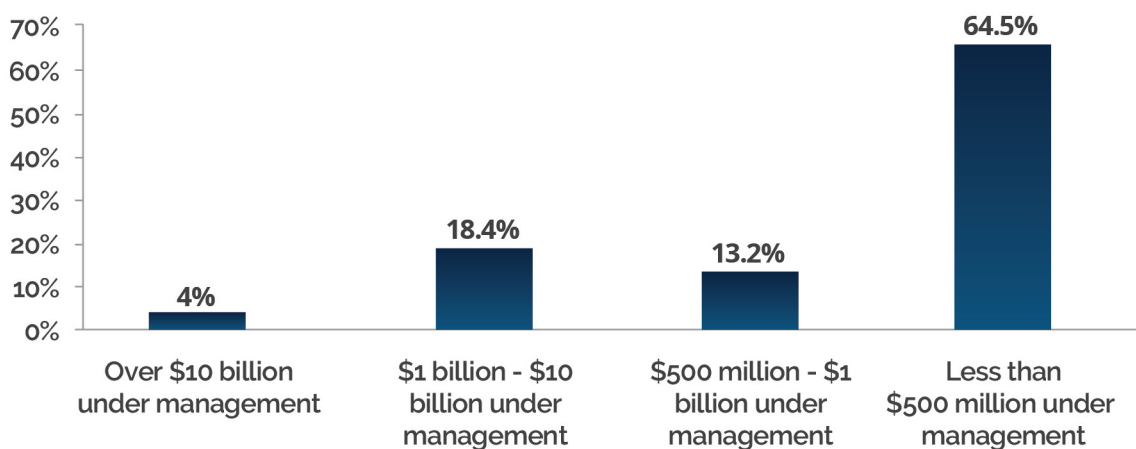
Title / Role (Private Equity Respondents)



IN RESPONSE TO: *What is your title / role with your organization?*

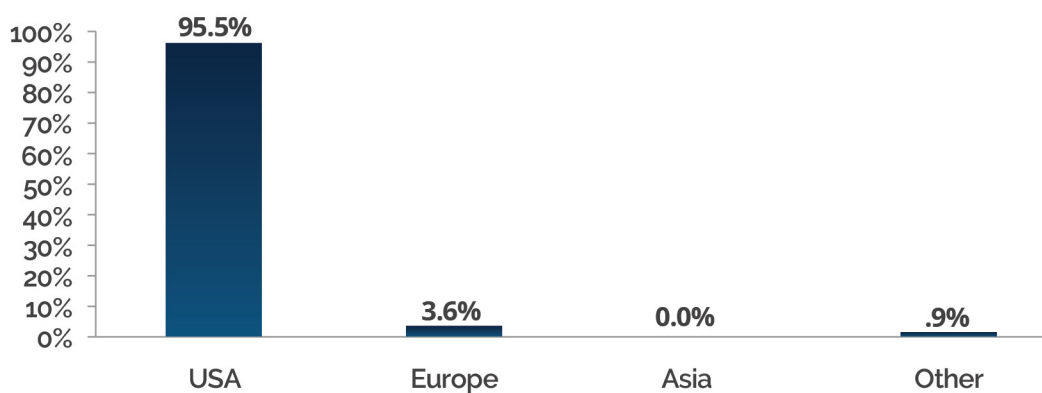
Among private equity respondents, about 36% have more than \$500 million in assets under management.

Size of Investment Fund (Private Equity Respondents)



Almost all respondents work for organizations headquartered in the U.S. A small percentage of the respondents are from Europe and Australia.

Location of Headquarters



IN RESPONSE TO: *Where is your organization headquartered?*

Select Recent KippsDeSanto & Co. Advised Transactions

<p>November 2018</p> <p>BEI PRECISION SYSTEMS & SPACE COMPANY</p> <p>a portfolio company of</p> <p>J.F. Lehman & Company</p> <p>has acquired</p> <p>THISTLE DESIGN</p>	<p>October 2018</p> <p>Power Manager Business of</p> <p>Protonex a Ballard® company</p> <p>a subsidiary of</p> <p>BALLARD</p> <p>has been acquired by</p> <p>REVISION</p>	<p>September 2018</p> <p>emagine it</p> <p>has received a strategic investment from</p> <p>ENLIGHTENMENT CAPITAL</p>	<p>September 2018</p> <p>CAPEWELL AERIAL SYSTEMS LLC</p> <p>a portfolio company of</p> <p>CAPITALWORKS</p> <p>has been acquired by</p> <p>ARGOSY PRIVATE EQUITY</p>
<p>August 2018</p> <p>Mac3 Mac3 Systems, LLC</p> <p>has been acquired by</p> <p>ALION SCIENCE AND TECHNOLOGY</p> <p>a portfolio company of</p> <p>VERITAS CAPITAL</p>	<p>July 2018</p> <p>Ai Aitech</p> <p>has been acquired by</p> <p>FIMI Opportunity Funds</p>	<p>July 2018</p> <p>GERMANE SYSTEMS™</p> <p>has been acquired by</p> <p>mercury systems</p>	<p>July 2018</p> <p>GenNx360 Capital Partners</p> <p>has acquired</p> <p>PAG PAG Aerospace, Inc.</p> <p>a portfolio company of</p> <p>PNC RIVERARCH CAPITAL</p>
<p>May 2018</p> <p>TMA Complex Problems Solved</p> <p>has been acquired by</p> <p>NS2 NATIONAL SECURITY SERVICES</p>	<p>April 2018</p> <p>STRATEGIC RESOURCES INTERNATIONAL</p> <p>has been acquired by</p> <p>Peraton™</p> <p>a portfolio company of</p> <p>VERITAS CAPITAL</p>	<p>February 2018</p> <p>THEMIS</p> <p>has been acquired by</p> <p>mercury systems</p>	<p>January 2018</p> <p>rgs</p> <p>a portfolio company of</p> <p>CM EQUITY PARTNERS</p> <p>has been acquired by</p> <p>USfalcon</p>
<p>January 2018</p> <p>BTP Systems Engineering and Technical Services</p> <p>has been acquired by</p> <p>serco</p>	<p>January 2018</p> <p>ADG CREATIVE BE HEARD™</p> <p>has been acquired by</p> <p>CHENEGA CORPORATION</p>	<p>November 2017</p> <p>AVANCE</p> <p>has been acquired by</p> <p>MAG AEROSPACE</p> <p>supported by</p> <p>CLAIRVEST</p>	<p>October 2017</p> <p>dominion CONSULTING</p> <p>has merged with</p> <p>TERATHINK</p>

About KippsDeSanto & Co.

KippsDeSanto & Co. is the largest independent investment banking firm exclusively focused on serving leading, growth-oriented Aerospace/Defense, Government Services and Technology companies. We are focused on delivering exceptional M&A and Financing transaction results to our clients via leveraging our scale, creativity and industry experience. We help market leaders realize their full strategic value. Having advised on over 100 industry transactions, KippsDeSanto is recognized for our analytical rigor, market insight and broad industry relationships. There's no substitute for experience.

We welcome the opportunity to have a more detailed discussion of developments in our focus sectors. For more information, please contact us at (703) 442-1400.

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