

Aerospace / Defense & Government Services 2020 M&A Survey

AS OF JANUARY 31, 2020



The past few years have seen strong merger and acquisition activity and valuations in the Aerospace / Defense and Government Services sectors. Some suggested the peak was near. However, market momentum suggested otherwise entering 2020.

For this third annual survey, KippsDeSanto asked key dealmakers from the Aerospace / Defense and Government Services sectors to share their perspectives about M&A deal activity and priorities for 2020. We also asked them to share their insights on strategic drivers of M&A activity including the upcoming U.S. federal elections happening in the fall of this year. The results suggested 2020 may be another active year for M&A.

This survey was conducted prior to major market developments resulting from COVID-19. Therefore, we are excluding results on dealmakers' predictions for overall economic activity and M&A activity in 2020. This report also does not represent a detailed analysis or predictions of the impact or non-impact of the developing COVID-19 situation on our focus areas.

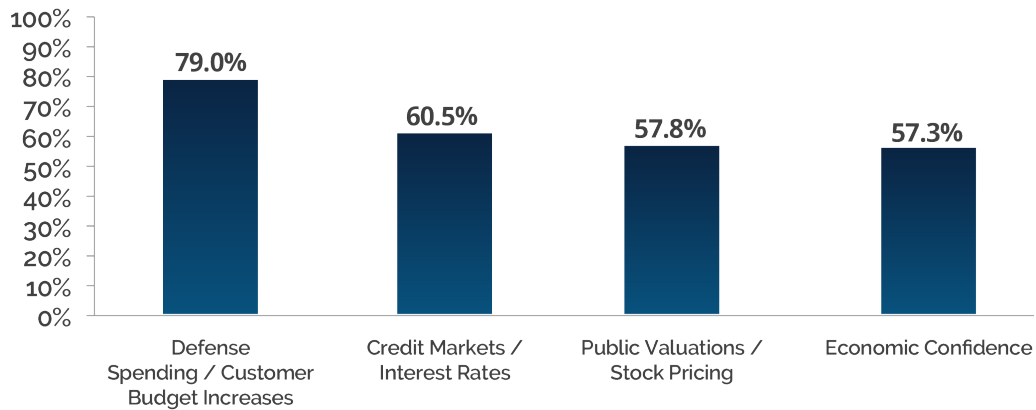
More than 200 dealmakers in the Aerospace / Defense and Government Services sectors participated in the survey — including many of the largest and most active industry buyers. This includes over 100 CEOs, presidents, CFOs, corporate development executives, or other executive level respondents from corporate / strategic buyers, and nearly 70 private equity partners and senior professionals.

“Over the past five years, we have witnessed strong M&A activity in the Aerospace / Defense and Government Services sectors reaching near decade highs in terms of valuations and deal announcements in 2019. As a leading investment bank focused exclusively on these sectors, we are in a unique position to understand the dynamics driving M&A 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 the Aerospace / Defense and Government Services sectors.”

M&A Drivers

Defense spending continues to be the most important factor influencing overall deal activity and target valuations in the Aerospace / Defense and Government Services sectors. Seventy-nine percent of all respondents say it is extremely or very influential — the same as in 2019. Economic confidence, public valuations / stock pricing, and credit markets / interest rates are all similar and secondary in importance. About 61% of respondents say they are extremely or very influential in deal activity and valuations — also similar to 2019 results. However, credit markets / interest rates increased in importance compared to 2019.

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



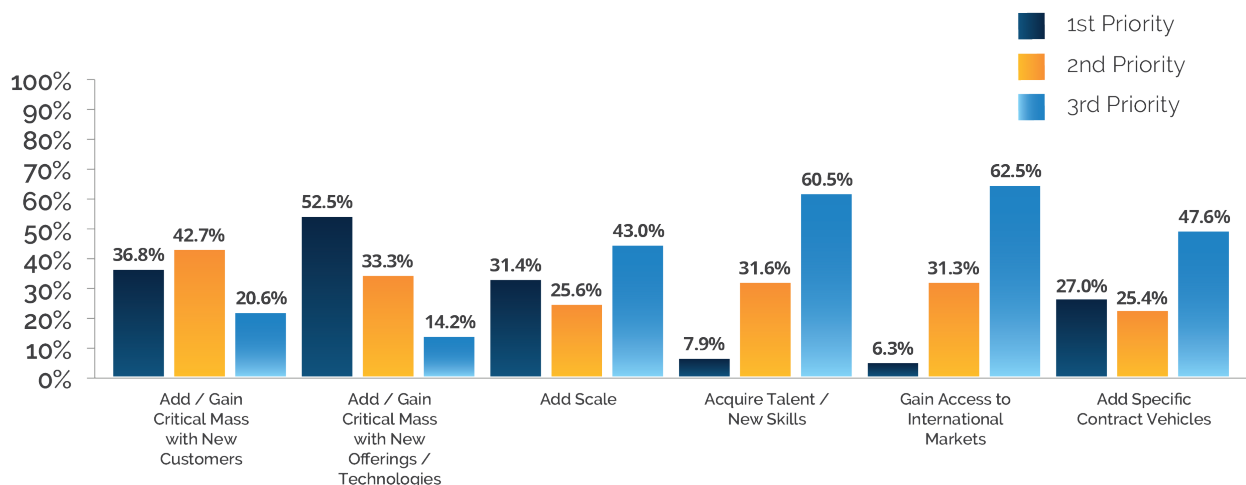
IN RESPONSE TO: Rate the following factors based on how much influence they have on overall deal activity and target valuations in the U.S.

Primary Buyer M&A Goals

When asked to rank their top M&A goals, 86% of dealmakers rate adding critical mass with new offerings / technologies as a first or second priority and 80% rate adding critical mass with new customers as a first or second priority. However, adding critical mass with new offerings / technologies is a clearer first priority this year chosen by 52% of respondents compared to just 37% who chose adding critical mass with new customers as a first priority. In 2019, these two were chosen as first or second priority by a nearly even percentage of respondents. Adding scale continues to be a third priority.

In 2020, three new possible M&A goals were added: acquire talent / new skills, gain access to international markets, and add specific contract vehicles. Adding a specific contract vehicle is the most important of these three, chosen as a first or second priority by 52% of respondents. Acquiring new talent or skills and gaining access to international markets are the least important, chosen as a third priority by over 60% of respondents.

M&A Strategy Goals

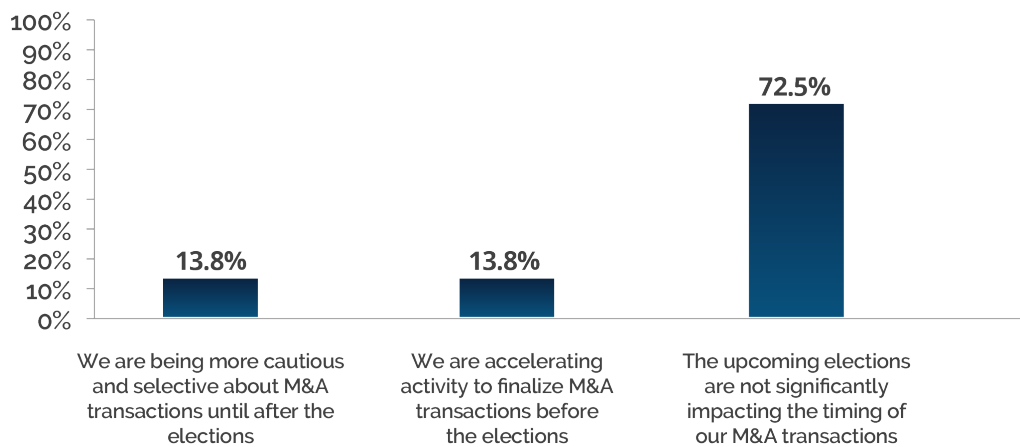


IN RESPONSE TO: Please rank how important the following goals are in your organization's M&A strategy.

Impacts of Political Changes on M&A Activity

Dealmakers were asked if the 2020 U.S. federal elections will impact their M&A strategy. Nearly three quarters of respondents (73%) say these elections will not impact the timing of their M&A strategy. Interestingly, the respondents who say the upcoming elections will impact their timing are evenly split (14% each) on if they are being more cautious and selective until the elections are over or if they are accelerating M&A activity to finalize transactions before the elections.

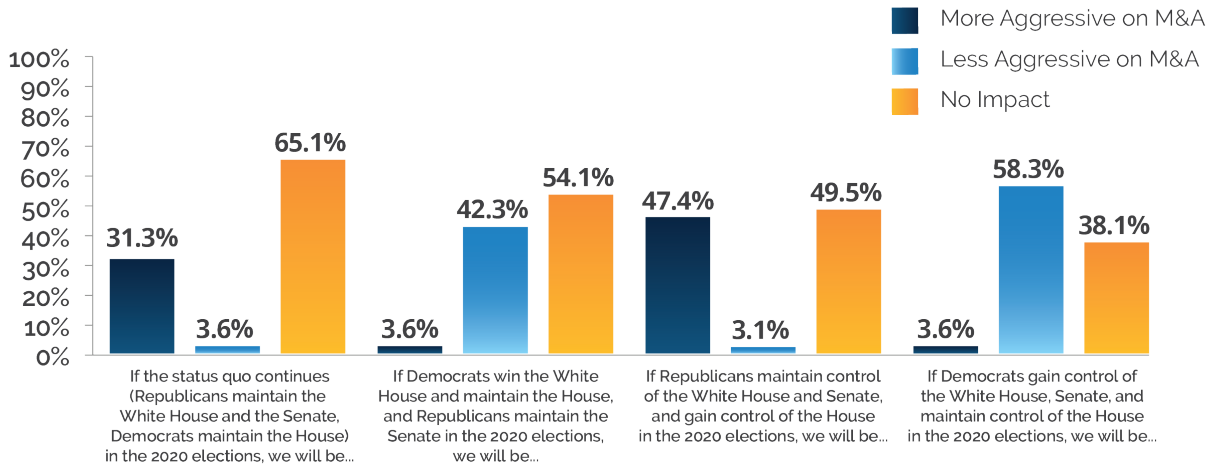
Impact of November 2020 Federal Elections on Timing of M&A Strategy



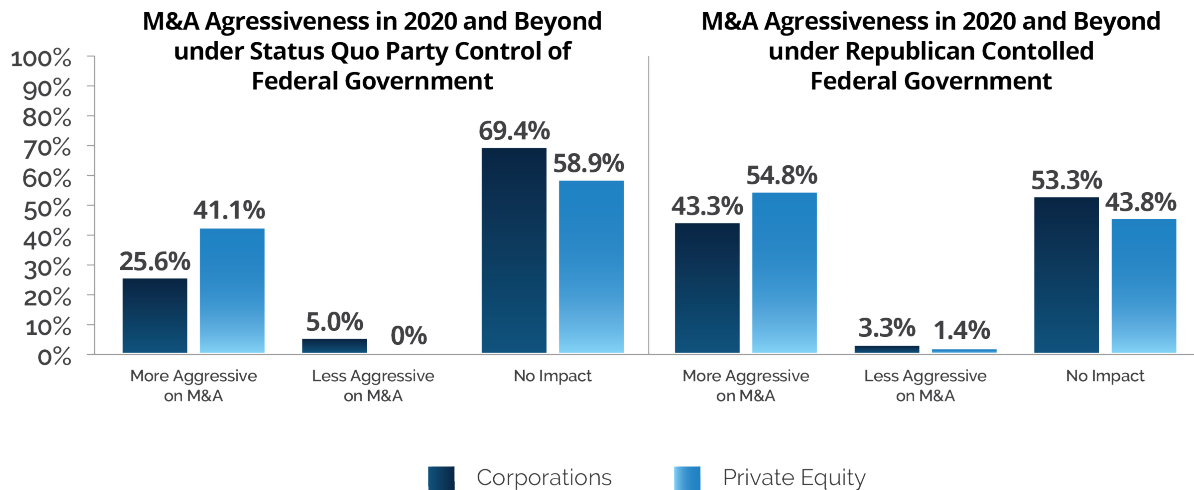
IN RESPONSE TO: *How will the November 2020 federal elections impact the timing of your M&A strategy in 2020?*

Dealmakers also responded to how different election outcome scenarios for party control of the White House, Senate and House would impact their M&A strategy in 2020 and beyond. There is a clear trend toward more aggressive M&A activity under Republican control scenarios than Democratic control. Respondents would generally be more aggressive if the status quo (Republican control of White House and Senate) continues (31% more aggressive) or if Republicans gain more control by winning the House as well (47% more aggressive), than if Democrats gain more control by winning the White House (42% less aggressive) or by winning the White House and the Senate (58% less aggressive).

Impact of Party Control Outcomes of November 2020 Federal Election Results on M&A Strategy in 2020 and Beyond



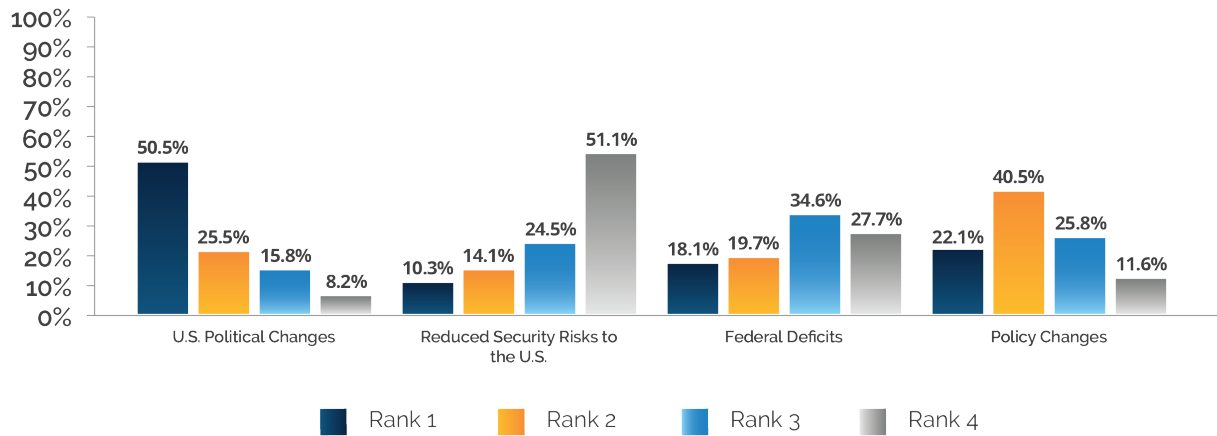
There are some small differences between respondents from corporate versus private equity organizations: a larger number of private equity respondents say they are likely to be more aggressive under the status quo party control or Republican take-all scenario than corporate respondents.



IN RESPONSE TO: How would the following potential outcomes of the November 2020 federal elections impact your M&A strategy in 2020 and beyond?

Respondents also note that political changes could have negative impacts on M&A activity, as they pose the greatest perceived risks to budgets and growth prospects. Dealmakers ranked 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. These results are similar to 2019.

Risks to Budgets and Growth Prospects

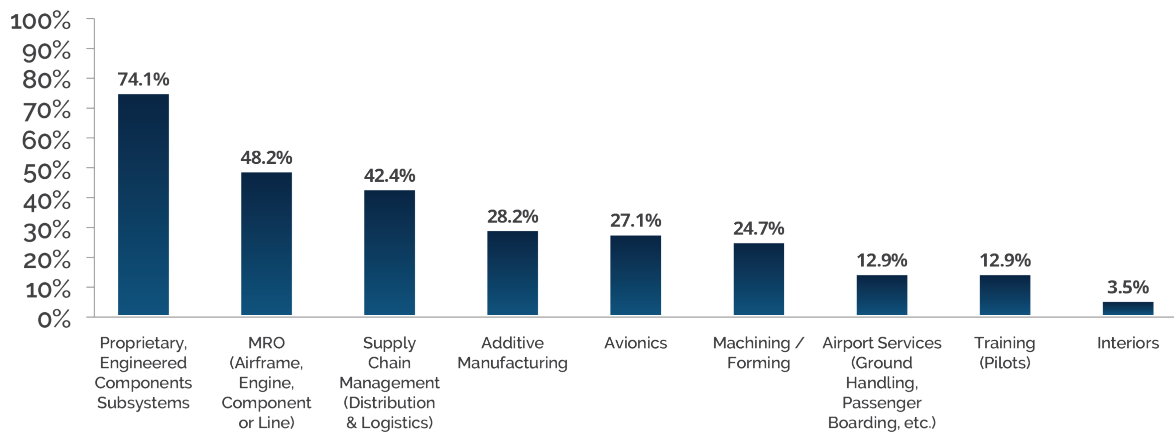


IN RESPONSE TO: Rank the following based on which you think present the biggest overall risks to budgets and growth prospects, 1 = biggest risk and 4 = smallest risk

Top M&A Interest Areas by Industry Sector

In the **Aerospace sector**, Proprietary, Engineered Components / Subsystems is the top priority for 74% of respondents, remaining the top priority interest area for three years in a row. However, respondents' prioritization of other target areas shifted since 2019 and are more similar to 2018. In 2020, MRO (airframe, engine, component or line) is the second most chosen priority area (48%), returning to the top three in 2020, after dropping to fifth in 2019. Supply Chain Management remained important, ranking as the third most chosen priority area (42%), down from second in 2019 and up from fourth in 2018. Machining / Forming dropped to sixth in 2020, chosen as a priority area by just 25% of respondents, down from third most important in 2019 when it was chosen as a priority area by 33% of respondents.

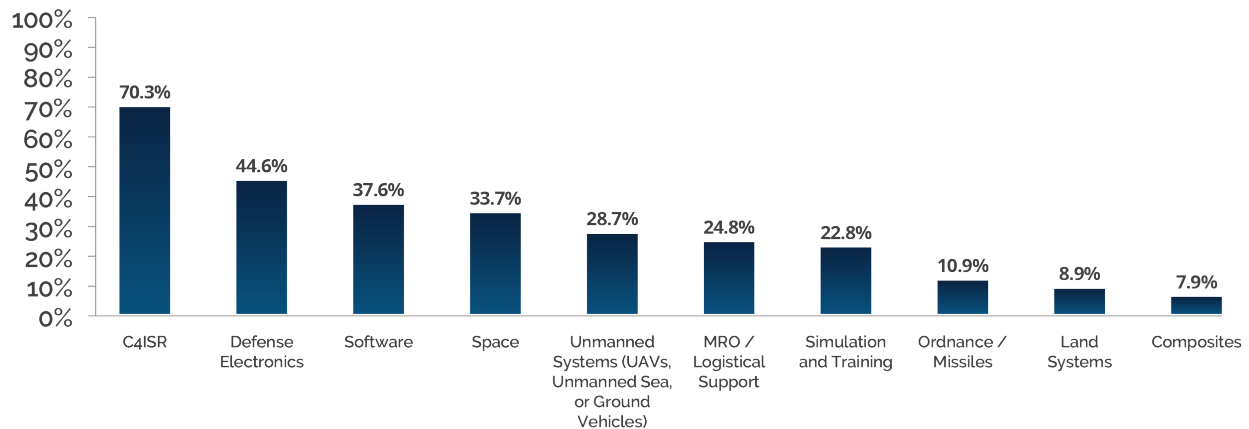
Aerospace Priority Interest Areas (% chosen as a priority area)



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 Aerospace sector over the next 12 to 24 months. You may only choose and rank three target areas.

In the **Defense sector**, the top two priority M&A interest areas for 2020 are similar to those chosen for both 2019 and 2018. C4ISR and Defense Electronics are again the highest priorities (chosen as a priority area by 70% and 45% respondents respectively). Software rose to the third-place spot, up from fourth in 2019, chosen as a priority area by 38% of respondents. For the first time in the three years of this survey, Space rounded out the top four, chosen as a priority interest area by 34% of respondents. Unmanned Systems, which was in the top four priority areas in 2018 and 2019 — and chosen as a priority area by 37% of respondents in both of those years — dropped out of the top four in 2020 and selected as a priority area by just 29% of respondents.

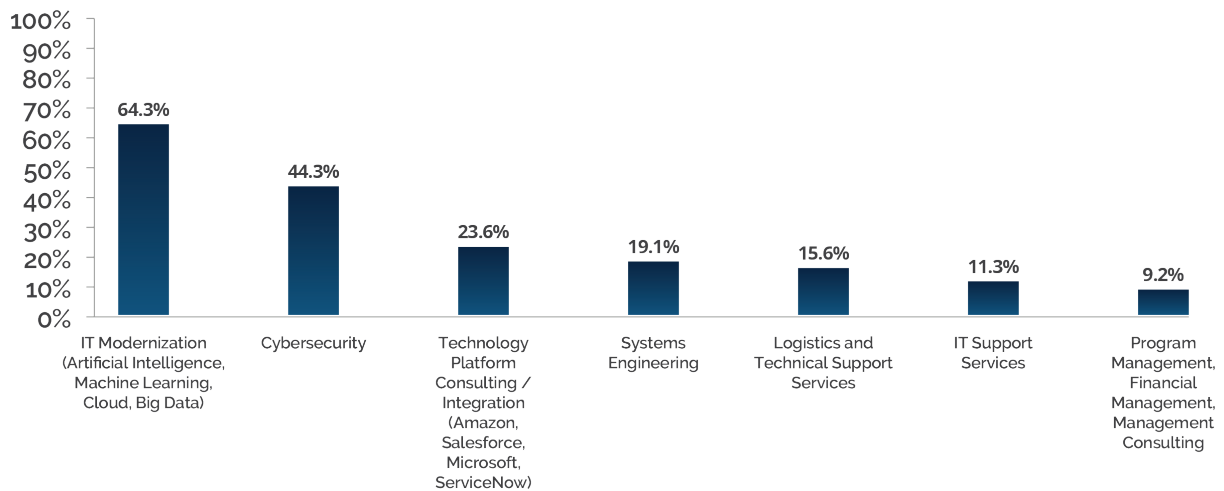
Defense Priority Interest Areas (% chosen as a priority interest area)



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, the same as in 2018 and 2019. However, IT Modernization is chosen as a priority interest area by a much larger percentage of respondents in 2020 (64% chose IT Modernization versus 44% for Cybersecurity). They were chosen as a priority area by a near-equal percentage of respondents (about 45% each) in 2019. Technology Platform Consulting / Integration is the third most important priority area in 2020, replacing Systems Engineering, which dropped to fourth in 2020 after being the third most important in 2018 and 2019.

Government Services Priority Areas (% chosen as top priority)

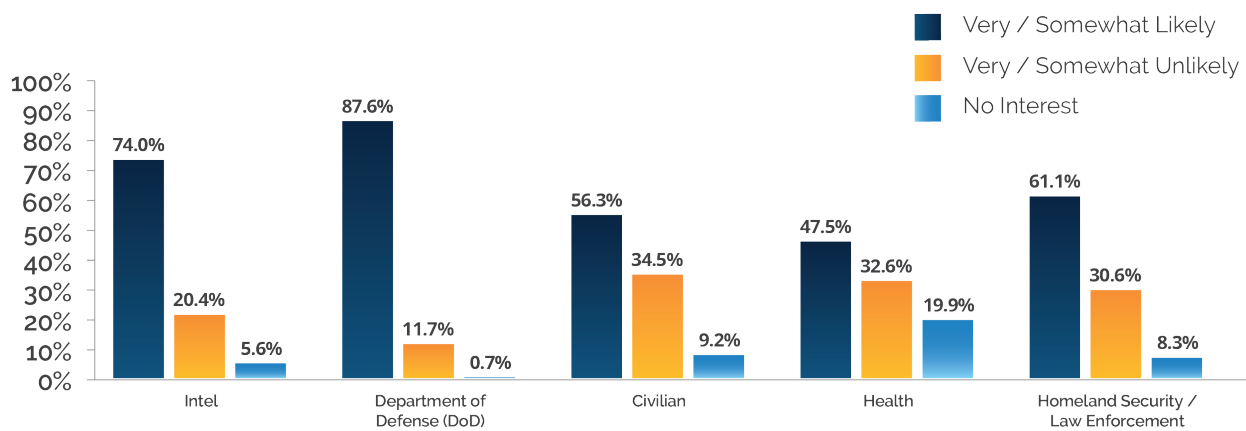


IN RESPONSE TO: Rate the following capabilities based on their importance for your organization's M&A strategy in the Government Services sector over the next 12 to 24 months.

Respondents interested in Government Services were asked how likely they are to seek targets in a range of key end markets. Department of Defense is again the most popular, with 88% of respondents very or somewhat likely to seek targets in this end market in 2020. This is even higher than in 2019, when 78% of respondents said they were very or somewhat likely to seek targets in this market. Intel remains the second highest priority, with 74% of respondents saying they are very or somewhat likely to seek targets in this market. This is also up from 63% in 2019.

Private equity dealmakers are significantly more interested in Intel, Civilian and Homeland Security / Law Enforcement than corporate respondents, which is similar to 2019.

Priority End Markets for the Government Services Sector



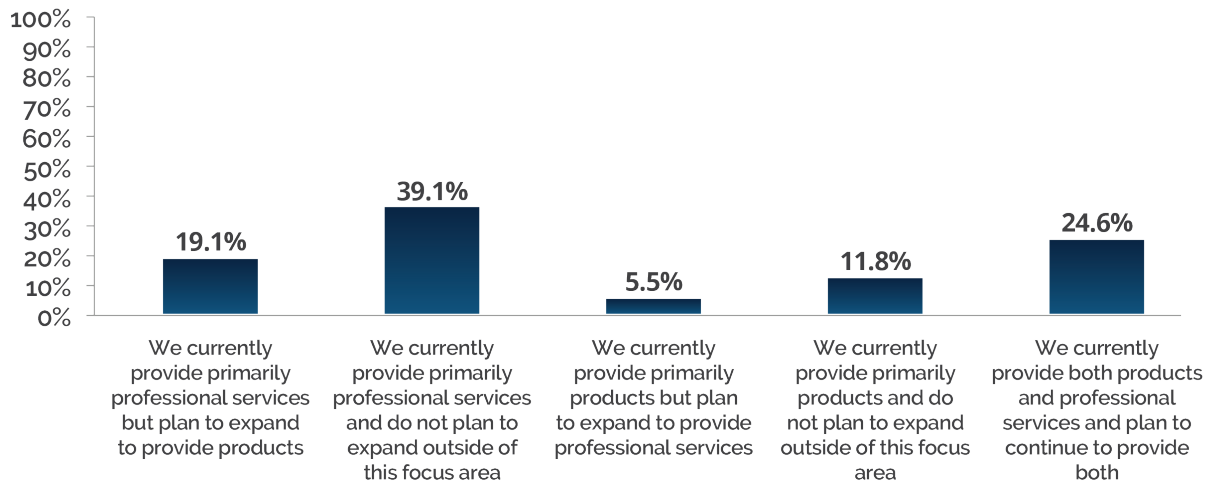
IN RESPONSE TO: How likely are you to seek U.S.-based targets in the following end markets over the next 12 to 24 months? (Asked of respondents interested in government services only.)

Product and Service Focus Areas and Expansion Plans

Corporate respondents were asked to share their focus areas and plans for expanding focus areas in 2020. Specifically, respondents were asked if they primarily provide professional services or products, and if they plan to expand their focus, if they don't already work in both areas. Overall, a majority of respondents plan to stick with their current focus area rather than expand or change focus.

About 60% of corporate respondents primarily provide professional services. About 39% do not plan to expand to products in 2020, while 20% do plan to expand to services. Just 17% of respondents currently provide primarily products. Only 6% plan to expand into professional services, while 12% do not. One quarter of respondents provide both professional services and products and plan to continue with both focus areas.

Focus Areas and Plans to Expand

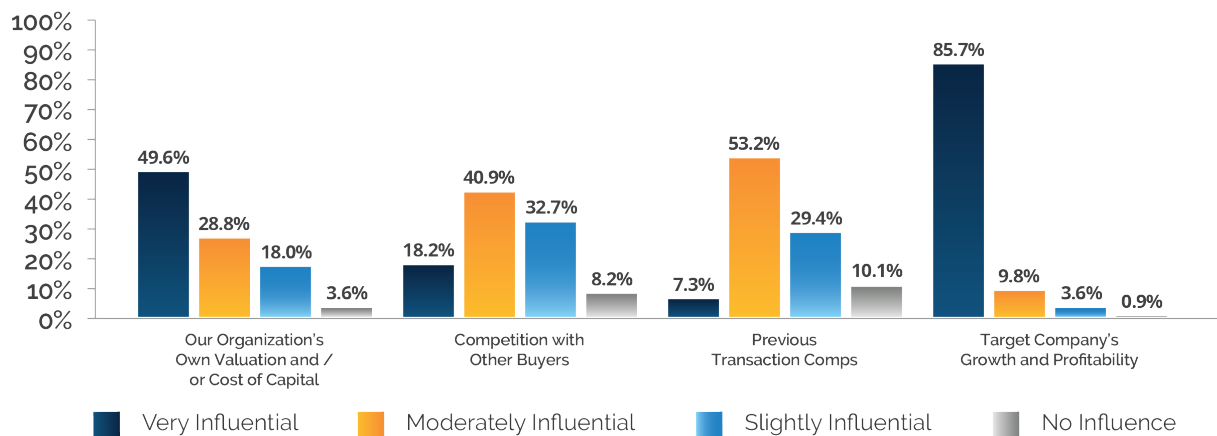


IN RESPONSE TO: Which of the following best describes your expansion plans for 2020? (Asked of corporate respondents only.)

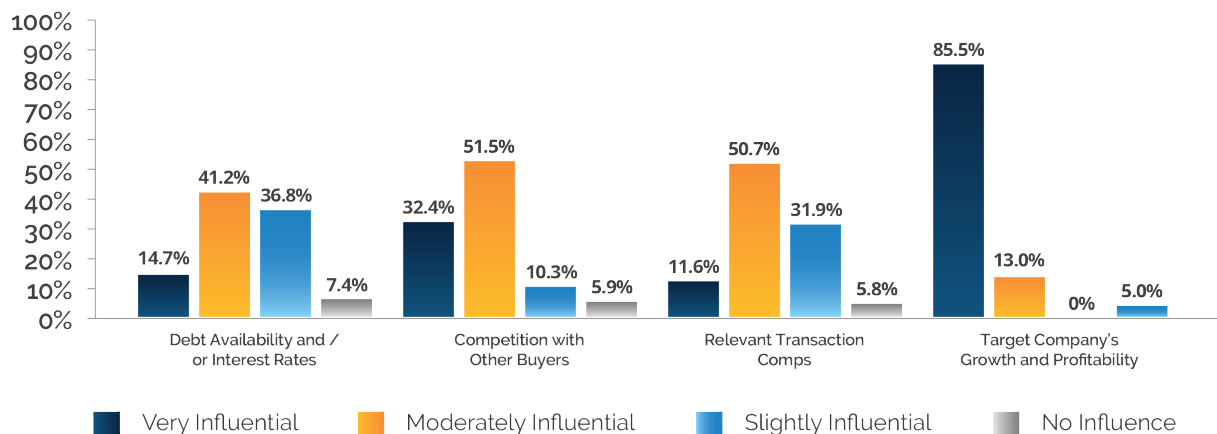
Factors Influencing Target Valuations

Dealmakers were asked to assess some key factors that may influence their valuations of potential targets. Over 85% of corporate and private equity respondents say that a target company's growth and profitability are by far the most influential valuation factor — the same as in 2019. For corporate respondents, their organization's own valuation and / or cost of capital is the second most influential factor, rated as very or moderately influential by 78% of respondents. For private equity respondents, competition with other buyers is the second most influential factor, rated as very or moderately influential by 84% of respondents. These results are similar to 2019.

Factors Influencing Target Valuations (Corporate Respondents)



Factors Influencing Target Valuations (Private Equity Respondents)



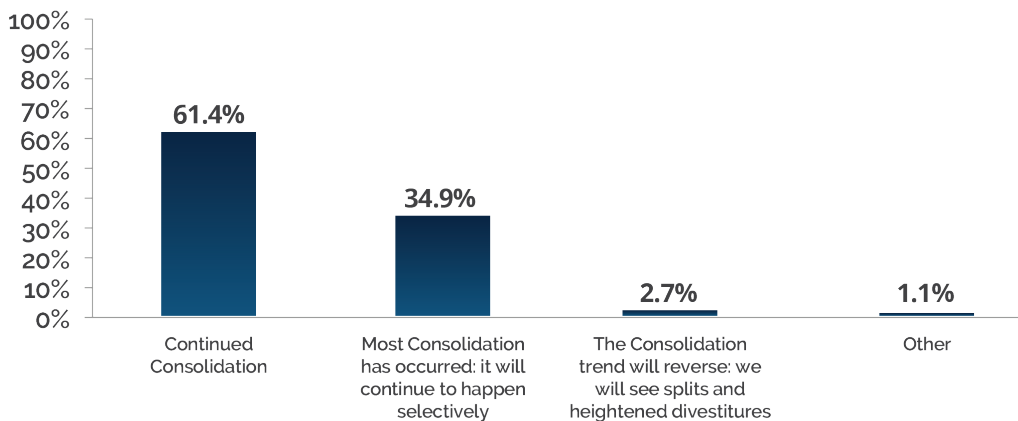
IN RESPONSE TO: How much influence do each of the following factors have in your valuation of potential U.S.-based targets?

Most Expect Consolidation to Continue

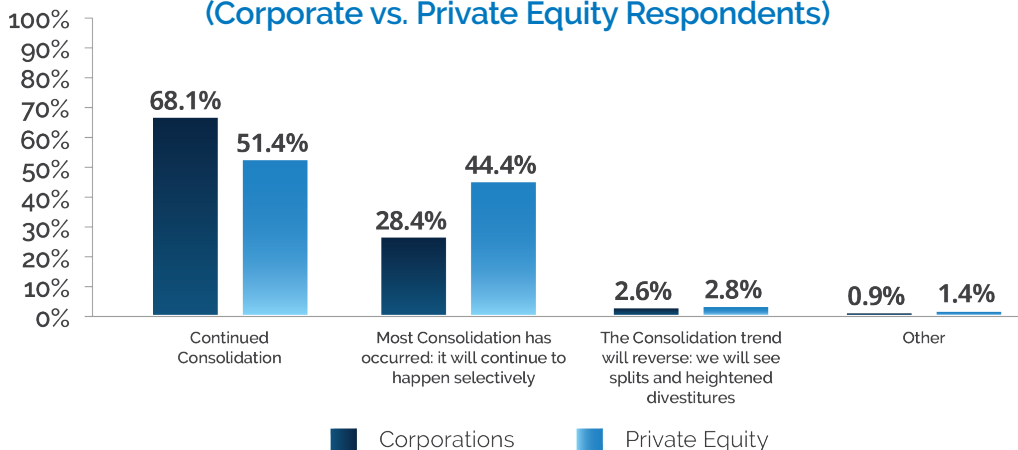
Also new for 2020, dealmakers were asked about their predictions for consolidation of publicly traded Aerospace / Defense and Government Services companies. About 61% of respondents predict continued consolidation. About 35% of respondents believe most of the consolidation has occurred, but will continue to happen selectively. Less than 3% of respondents expect the trend to reverse and divestitures or splits to increase.

Corporate respondents have greater conviction around continued consolidation than private dealmakers: nearly 70% of corporate respondents expect continued consolidation compared to 51% of private equity respondents. Similarly, more private equity dealmakers predict that most consolidation has happened. About 44% of private equity respondents say most consolidation has happened, but it will continue to happen selectively. This compares to just 28% of corporate respondents who believe this.

Predictions about Consolidation Trend for Publicly Traded Aerospace / Defense and Government Services Companies



Predictions about Consolidation Trend (Corporate vs. Private Equity Respondents)

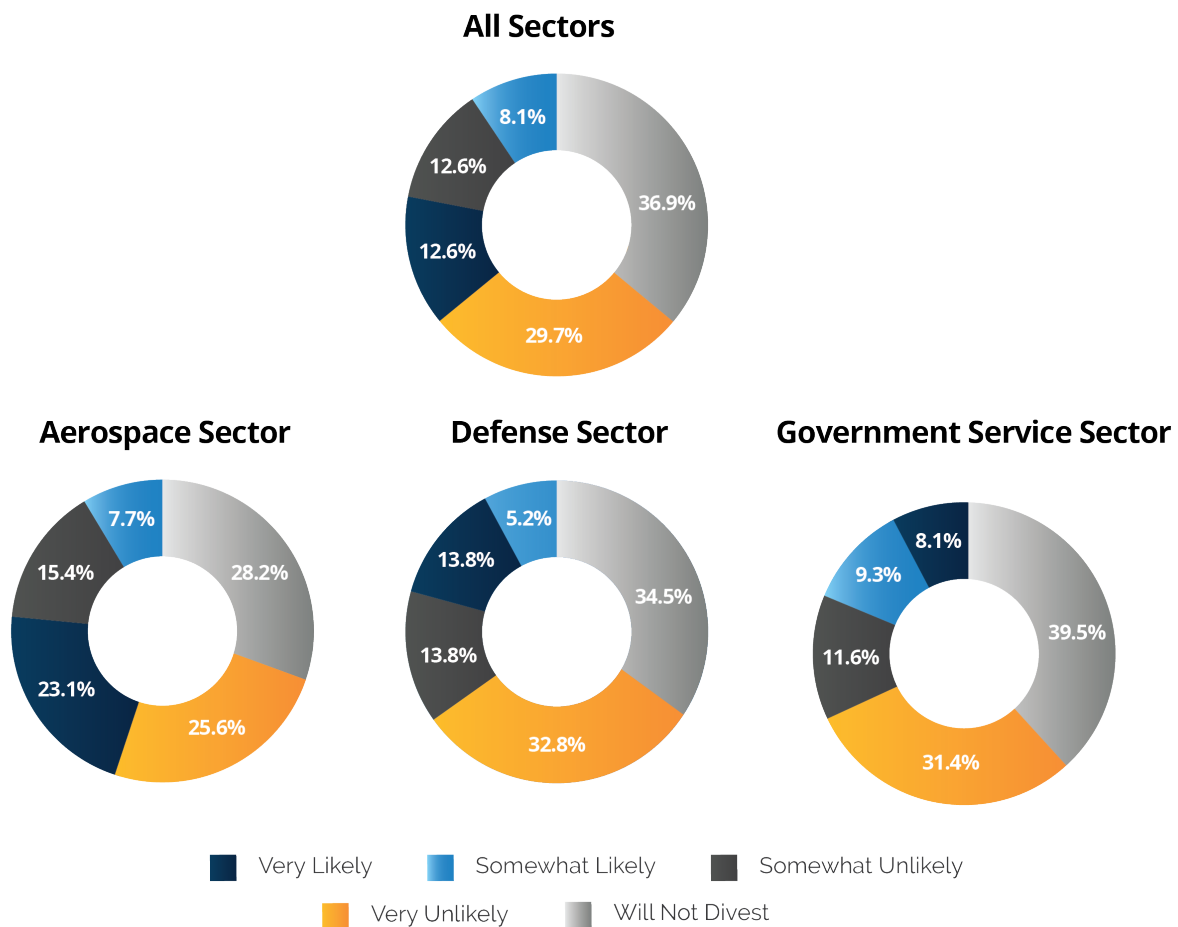


IN RESPONSE TO: *What is your outlook on continued consolidation of publicly traded Aerospace / Defense and Government Services companies? I expect ...*

Divestiture Predictions Remain Mixed Across Sectors, but Differences are Less Pronounced than in Previous Years

To further assess consolidation and divestiture activity, corporate dealmakers were asked how likely they are to divest of any units or operations over the next 12 months. Overall, respondents are less likely to divest than in 2019. Approximately 79% of respondents say they are somewhat unlikely, very unlikely or will not divest (up from 70% in 2019), while just 21% say they are somewhat or very likely to divest (down from 29% in 2019). As in previous years, respondents interested in the Government Services sector are significantly less likely to divest than those interested in Aerospace or Defense. About 71% of those interested in Government Services say they are very unlikely to or will not divest compared to 67% of respondents interested in Defense and 54% interested in Aerospace. The sectoral differences in likelihood of divesting are less pronounced than in previous years, with a higher percentage of respondents in all sectors saying they are unlikely to divest.

Likelihood of Divesting Units or Operations in the Next 12 Months



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

Select Recent KippsDeSanto & Co. Advised Transactions

<p>February 2020</p>  <p>has been acquired by</p>  <p>a portfolio company of</p> <p>The Jordan Company</p>	<p>January 2020</p> <p>INTELLIVARE</p> <p>has been acquired by</p>  <p>to form</p> <p>IntelliBridge</p> <p>a portfolio company of</p> <p>ENLIGHTENMENT CAPITAL</p>	<p>December 2019</p>  <p>has been recapitalized by</p> <p>OCEANS&UND PARTNERS</p>	<p>October 2019</p>  <p>has been acquired by</p> <p>A C P</p>	<p>October 2019</p>  <p>a portfolio company of</p> <p>J.F. Lehman & Company</p> <p>has acquired</p> 
<p>September 2019</p>  <p>has been acquired by</p> 	<p>September 2019</p>  <p>has been acquired by</p>  <p>a portfolio company of</p> <p>The Jordan Company</p>	<p>August 2019</p>  <p>a portfolio company of</p>  <p>has been acquired by</p> 	<p>August 2019</p>  <p>has been acquired by</p>  <p>a portfolio company of</p> 	<p>August 2019</p>  <p>has been acquired by</p>  <p>a</p> 
<p>July 2019</p>  <p>ALTAMIRA</p> <p>a portfolio company of</p> <p>Columbia Capital & RAZORS EDGE</p> <p>has been acquired by</p>  	<p>July 2019</p>  <p>has been acquired by</p>  <p>a portfolio company of</p> <p>A C P</p>	<p>July 2019</p>  <p>has been acquired by</p>  <p>a portfolio company of</p> 	<p>June 2019</p>  <p>has acquired</p> 	<p>June 2019</p> <p>TRAUMA FX[®]</p> <p>a subsidiary of</p>  <p>has been acquired by</p>  <p>a portfolio company of</p> 
<p>June 2019</p>  <p>has been recapitalized by</p> <p>CM EQUITY PARTNERS</p>	<p>April 2019</p>  <p>has been acquired by</p> 	<p>April 2019</p>  <p>a subsidiary of</p>  <p>has been acquired by</p> 	<p>April 2019</p>  <p>a subsidiary of</p>  <p>has been acquired by</p> 	<p>February 2019</p>  <p>a portfolio company of</p> <p>THE CARLYLE GROUP</p>  <p>and</p>  <p>has been acquired by</p> 

About KippsDeSanto & Co.

KippsDeSanto & Co. is an investment bank focused on delivering exceptional results for leading, growth-oriented Aerospace / Defense, Government Services and Technology companies. We leverage our creativity and industry experience to provide M&A, private financing and strategic consulting. Our senior team has advised on over 200 transactions totaling more than \$17 billion in deal value. Capitalizing on real-time industry trends and in-depth technical and strategic analysis, our solutions-driven approach is highly structured and uniquely tailored to each client. We are recognized for our market insight and broad industry relationships. We help market leaders realize their full strategic value.

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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