



# Future of M&A in Aerospace and Defense

KPMG in Belgium

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# Foreword

This is an exciting and challenging time to work in the Aerospace and Defense (A&D) industry. COVID-19 vaccines hold out the hope of a global economic recovery that will fuel a surge in M&A deals in A&D.

This report discusses that future M&A trends in the sector are to be shaped by three closely interconnected factors: geopolitics, the recovery from the pandemic and digital transformation.

To help our readers navigate this terrain, we outline the impact of these factors on the M&A within A&D transactions in North America, Europe and the Indo-Pacific over the next few years.

Politics, economics and technology will all play their part in industrial restructuring, an environment rich in M&A opportunities and risks. Geopolitical tension will stiffen governments' resolve to maintain defense spending. The dislocation of the airline industry caused by COVID-19 is likely to lead to consolidation, especially in civilian aerospace.

Urged on by stakeholders including governments, companies will invest in technology to transform their operations. They have little choice but to digitize, given the competitive pressures, and this has the potential to drive much of the M&A activity.

## What's coming next

Our Global Defense & National Security [team](#) is releasing a thought leadership report focusing on *Private Equity in Defense* so please keep an eye out for that.

Also, watch for an exciting paper from [KPMG's Global Space Practice](#), along with the Space Foundation, discussing *The Future of Defense in Space*. This report explores the hypothesis of how space will evolve as a military domain to support forces on the ground but also protect assets in space.



**Grant J McDonald**  
Global Head of Aerospace and Defense  
KPMG International



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# Mergers & Acquisitions in the Global Aerospace and Defense business

## **A deal surge ahead**

The year 2021 is likely to prove a turning point for the global Aerospace and Defense (A&D) industry in ways that will have significant implications for corporate dealmakers for years to come. Three major trends — geopolitics, the pandemic and digital transformation — have become powerfully intertwined. These factors are likely to lead to the restructuring of the A&D industry that will create opportunities and risks for A&D companies and financial sponsors looking for M&A.

This report will focus mainly on the US, Germany, Canada, India, the UK, France and Australia. It is based on interviews with KPMG leaders as well as insights gathered with our research partner, the Eurasia Group. The report begins by examining the three drivers of M&A in A&D, and then delves into the effects they will have on corporate deal making over the next several years.

## International power politics

International politics has always played a fundamental role in the development of A&D. The unipolar world of US leadership that emerged after the collapse of the Soviet Union has given way to a multipolar one that is dominated by US – China rivalry. This is inserting a wedge into the global economy while raising tensions among the great powers and lesser states. “We are in a world where great power politics has re-emerged as a significant driver of security policy,” says David Gordon, Eurasia Group.

In Asia, the rise of China is prompting the emergence of a balancing coalition made up of the US, Japan, South Korea and now, India. Indeed, for the first time, two of the five countries with the largest defense spending are in Asia, being China and India.<sup>1</sup> There is increasing uncertainty in Asia regarding the resilience of the US commitment to the region, and in response, “Asia will

continue to be the most dynamic region in terms of increased military spending,” he predicts.

The Middle East also, will continue to be a “very robust” market for military equipment. US allies in the region share a concern that Washington may pull back from engagement, a key reason for new diplomatic ties between Israel and the Gulf states.

In Europe, one important question is whether the EU, possibly with the UK, will try to carve out a role as a third geopolitical hub or try “to reinvent and rebalance” the transatlantic alliance, says Gordon. After Brexit, the UK may try to build a global presence, while France’s President Macron is likely to edge toward a Europe-led option. The geostrategic stance of Germany may be decided in parliamentary elections in September 2021.

As for the US, President Biden is likely to want to focus on strengthening its ties with other NATO members while strengthening its alliances in Asia.

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We are in a world where great power politics has re-emerged as a significant driver of security policy.”

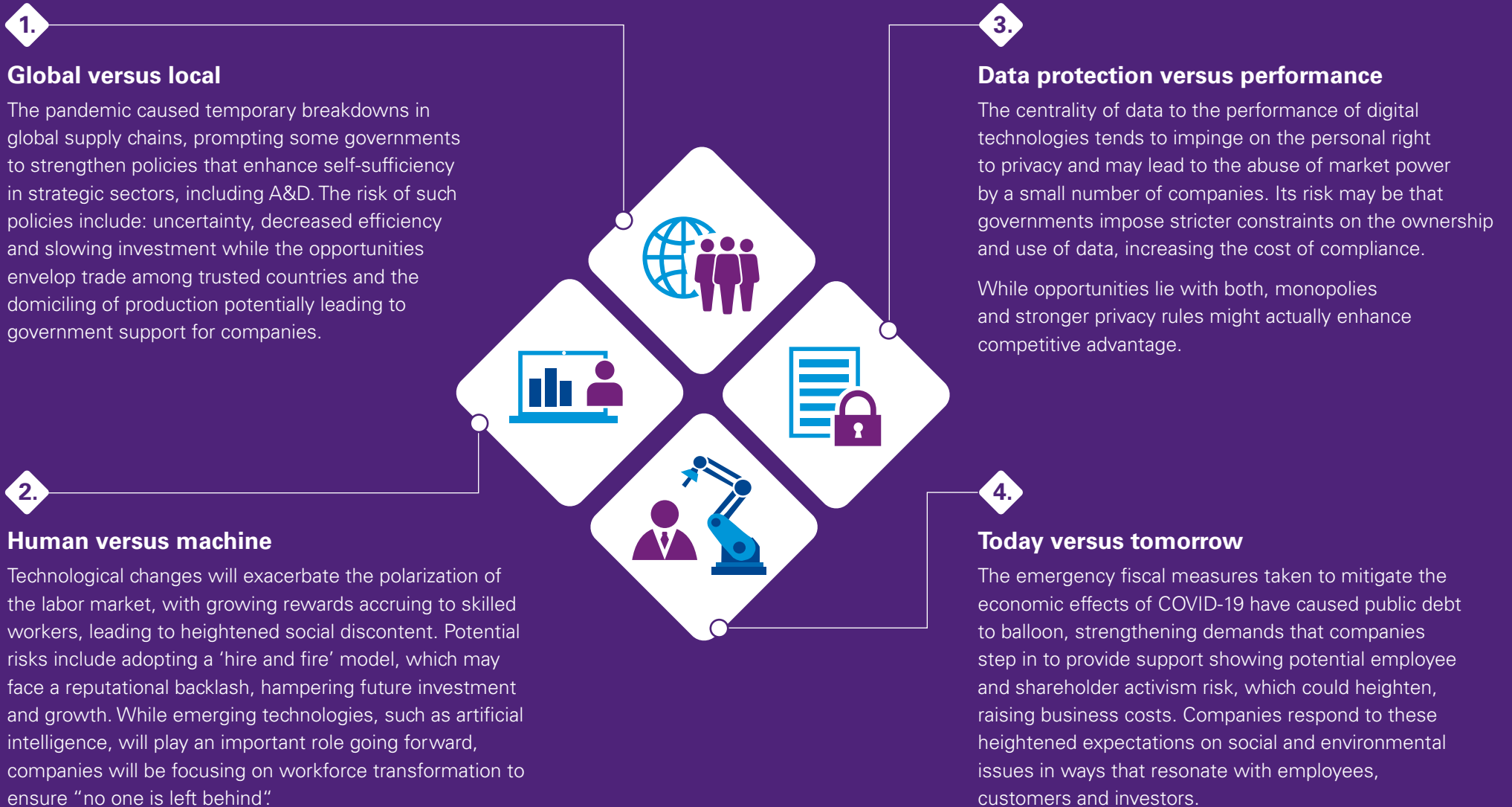
**David Gordon**  
Global Macro Strategist



<sup>1</sup> “Global military expenditure sees largest annual increase in a decade,” Stockholm International Peace Research Institute, April 27, 2020

## Geopolitical face-offs

KPMG International's partner Eurasia Group, a geopolitical risk consultancy, says that increased polarization of geopolitics will create challenges and opportunities for every type of business, including M&A in A&D. The Eurasia Group describes four 'face-offs':





## US outlook

The US A&D industry is likely to see a continuation of the disruption caused by the pandemic and the Federal Aviation Administration’s ban on flights of the Boeing 737 MAX, which was subsequently lifted in November 2020. In the coming year, there will be a renewed search for M&A opportunities in the world’s largest market after the industry scrambled to meet the challenges of a sudden, unprecedented drop in consumer demand for commercial flights. Corporate dealmaking is expected to accelerate as valuations moderate and A&D executives shift their focus toward core markets. If US companies invest domestically in critical technologies, this is likely to trigger a race to re-shore many tier II and tier III activities. Much of this investment will go into financial support for key suppliers as well as acquisitions. The Biden administration’s budget proposals suggest defense spending will stay flat or decline modestly over the next few years.

A&D dealmakers will have to navigate these policy shifts as they plan their strategies for the next two to three years. A Europe-first defense policy, for example, is likely to lead to significant M&A opportunities for both US and European companies. For US companies across the Atlantic, as well as European ones, achieving success would be difficult enough if geopolitics were the only consideration, but it has been made more complicated by additional drivers that include the acceleration of technological change spurred by the global pandemic.

## Global pandemic

The COVID-19 virus has battered the civilian aerospace industry while highlighting the vulnerability of global supply chains. Civilian airlines’ global revenue passenger kilometers (RPK) fell by 66 percent in 2020<sup>2</sup> and IATA predicts<sup>3</sup> the industry will not return to 2019 levels of demand until 2024, and there is considerable long-term uncertainty: the demand forecast for the latter year ranges from 7 trillion RPKs to 10.5 trillion. The fall-out will grow with time. A casualty of the downturn was

Boeing’s decision in April 2020 to cancel its offer to buy 80 percent of Embraer’s commercial jet business for US\$4.2 billion. The cloudy future of the civilian aviation market was among the reasons for the cancellation, as well as Boeing’s financial and legal difficulties with its 737 MAX jets.

Government budgets will be severely constrained for the foreseeable future, limiting their ability to further support the civilian aerospace industry. If there are across-the-board cuts in defense programs, this may cause A&D contractors with diverse product and service offerings to reshape their portfolios and refocus on core capabilities.

An example of the narrowing in focus is British aero-engine maker Rolls-Royce’s announcement in August 2020 that it would sell assets to raise more than US\$2.5 billion, including its Spanish aircraft engine manufacturer, ITP Aero, as it struggles to strengthen a balance sheet that has been stretched by the pandemic. In September, it was reported that it was in talks with sovereign wealth funds to raise an additional US\$3 billion from investors.<sup>4</sup>

“  
In the US, A&D consolidation is likely to accelerate, especially among under-capitalized and fragmented parts of the tier II/III supply base. Some may be forced to divest non-core assets to raise capital.”

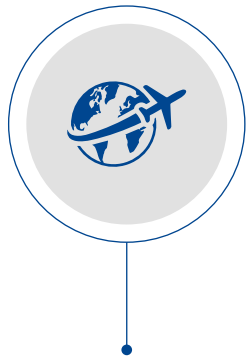
**Jim Adams**  
National A&D Industry Leader  
KPMG in the US

<sup>2</sup> “2020 worst year in history for air travel demand,” International Air Transport Association, February 3, 2021

<sup>3</sup> “COVID-19 outlook for air transport and the airline industry,” IATA, November 24, 2020

<sup>4</sup> “Rolls-Royce in talks with sovereign wealth funds to raise £2.5bn,” Financial Times, September 20, 2020

## Seven key global industry trends



01

### Impacts to airline and aerospace industry economics

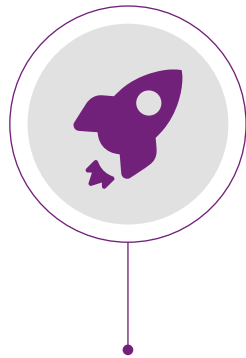
Resulting in further consolidation and deep cost cutting (international and domestic).



02

### Liquidity crush: supply base challenges

May accelerate vertical re-integration — may require actions from OEMs including acquisition, cash infusion, others.



03

### Accelerated consolidation

Of lower tier suppliers creating better scale and capital access.



04

### Global retrenchment

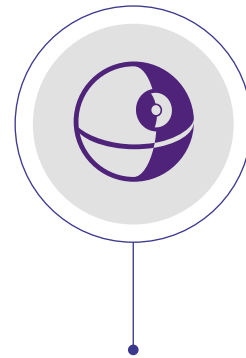
National champions may increasingly retrench into their home markets, as well as the rise of 'trusted capital'.



05

### Re-domiciling of critical technologies

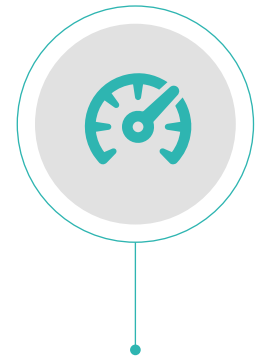
(i.e. micro-electronics, AI, etc.)



06

### Closure of the space gap

No new big programs meaning increasingly smaller, disaggregated mission programs.



07

### Acceleration of all things digital

Including secure supply chains, remote work, and collaboration.

Source: KPMG





## Canada outlook

Investment in innovative and emerging areas, such as the space sector, but more broadly in AI, additive manufacturing and other new technologies, will continue to be a focus for domestic players. On the defense side, with several significant government procurement projects underway, foreign-owned multinationals continue to scope out the Canadian market for opportunities to invest in small and medium entities that offer a niche capability to enhance their ability to participate in these programs. As the Canadian domestic market is not large and exports are important to success, Canadian companies are also looking to expand their global footprint in both developed and emerging A&D markets.

Heightened competition for fewer defense programs, and the possible re-emergence in the US of lowest-price, technically acceptable contracts, is likely to accelerate consolidation. “In the US, this could prompt the defense industrial base to enhance both vertical and horizontal integration strategies,” says Jim Adams, KPMG in the US.

## The need to innovate

The sudden economic downturn has accelerated digitalization, highlighting the importance of innovation, not least in the A&D industries. The world experienced a ‘sputnik moment’ in December 2020 when, on the same day a Chinese rocket collected samples on the moon’s surface, a key US radio telescope collapsed in Puerto Rico.<sup>5</sup> The coincidence underlined the fact that China may have surpassed the US in R&D spending as a share of GDP. This has obvious implications for geopolitics and A&D. The conclusion of two US analysts is that “America’s military needs an innovation overhaul.”<sup>6</sup>

One reason for this is that the nature of warfare is shifting from counterinsurgency and terrorism toward countering near peer adversaries and modernizing defensive infrastructure, driving investments in technology systems and communication networks.

To prevent such attacks in the future, governments must encourage collaborative innovation, says Jonathon Gill, KPMG in the UK. “Defense departments will have to be more intelligent customers and suppliers more intelligent partners with governments,” he says. “Traditional defense suppliers will need to broaden their skills.”

“There’s going to be an increasing focus on data analytics and cybersecurity, but there are a finite number of corporate targets, so the question is how these companies can carry on innovating rather than be bought by a primary supplier,” says Gill. “The challenge is going to be nurturing those innovations, while enabling M&A.” He believes that countries will be at an advantage where private equity firms are active and, through M&A, there will be diversity and inclusion in this field, rather than state control. “People with differing mindsets are more likely to spark innovations,” he concludes.

These three trends — geopolitics, the global pandemic’s after-effects, and digital transformation — may lead to a range of outcomes for A&D over the next 3 years, ranging from reshaped product portfolios and divestments to increased M&A as well as greater involvement of private equity. Before taking a closer look at the future trends, let us briefly analyze recent M&A developments in A&D.

“The global A&D sector is experiencing a time of profound change. The intersection of these trends, combined with the varying economic impact on the players, makes it imperative to undertake a review of M&A strategy.”

**Grant J McDonald**  
Global A&D Leader  
KPMG International

<sup>5</sup> “To the moon and back, Chinese R&D is leaving the US behind,” Financial Times, December 14, 2020

<sup>6</sup> “FAA lifts ban on Boeing 737 MAX after crashes in 2018 and 2019 grounded the jet,” Washington Post, November 18, 2020

A large military transport aircraft, possibly a C-17 Globemaster III, is shown from a low angle on a runway. The aircraft is silhouetted against a dramatic sky with soft, colorful clouds in shades of blue, purple, and orange, suggesting a sunset or sunrise. The aircraft's four engines and high-wing configuration are clearly visible. The runway surface is wet, reflecting the light from the sky.

# Trends in M&A deals worldwide

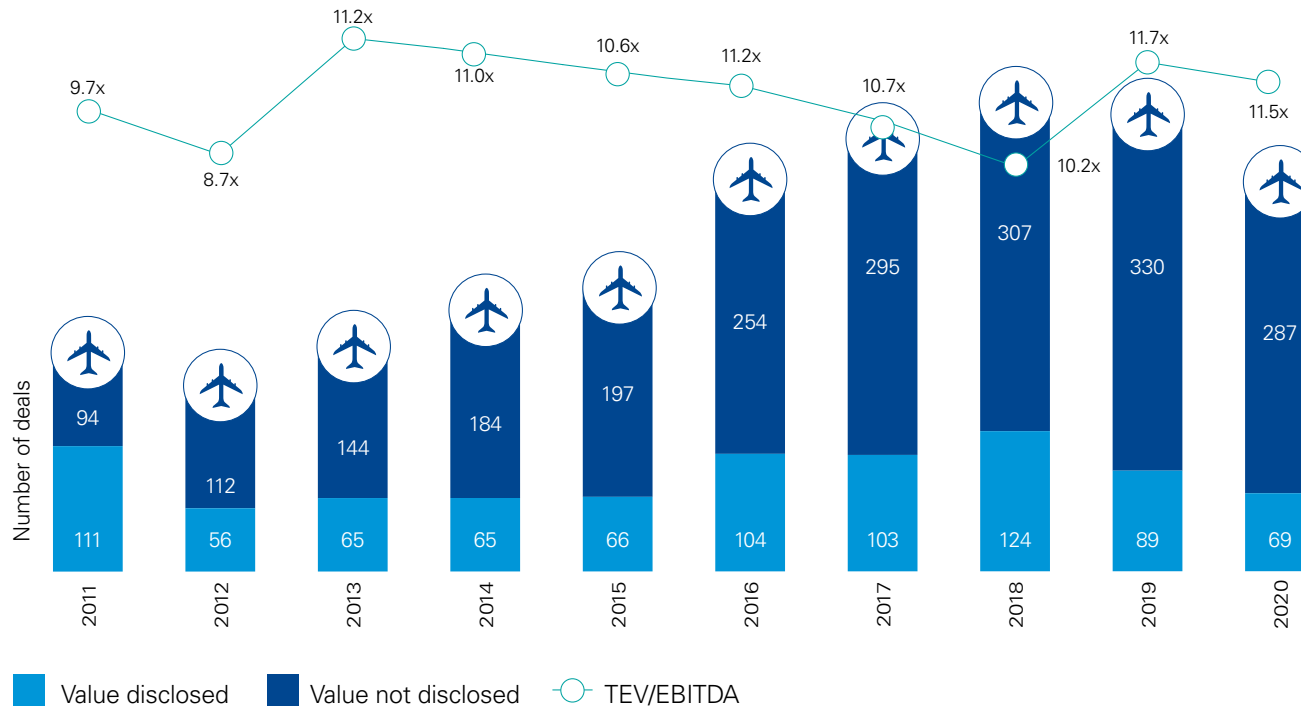
## The M&A market in A&D

Despite the strong impact of the pandemic and the grounding of the Boeing 737 MAX fleet, A&D has not yet seen widespread industry consolidation or a large number of bankruptcies. However, with mounting federal debt levels and the extended period of depressed commercial air travel, there is likely to be a significant number of small to mid-market deals in the tier II and III segments.

Deal activity declined in the latter half of 2019, driven by uncertainty around global trade tensions and moderating air travel. The effects of the pandemic brought M&A activity to a standstill in mid-2020. But then deal volumes rebounded at the end of the year, led by private equity buyers, with the defense segment of A&D driving almost all of the deal activity. Valuations remained elevated, as appetite for scarce quality assets has remained intact.

The number of initial public offerings (IPOs) have also increased and in the US Special Purpose Acquisition Companies (SPACs) have become popular avenues for taking target entities public, including a number in the aerospace sector.

### Total number of A&D deals and TEV/EBITDA multiples globally



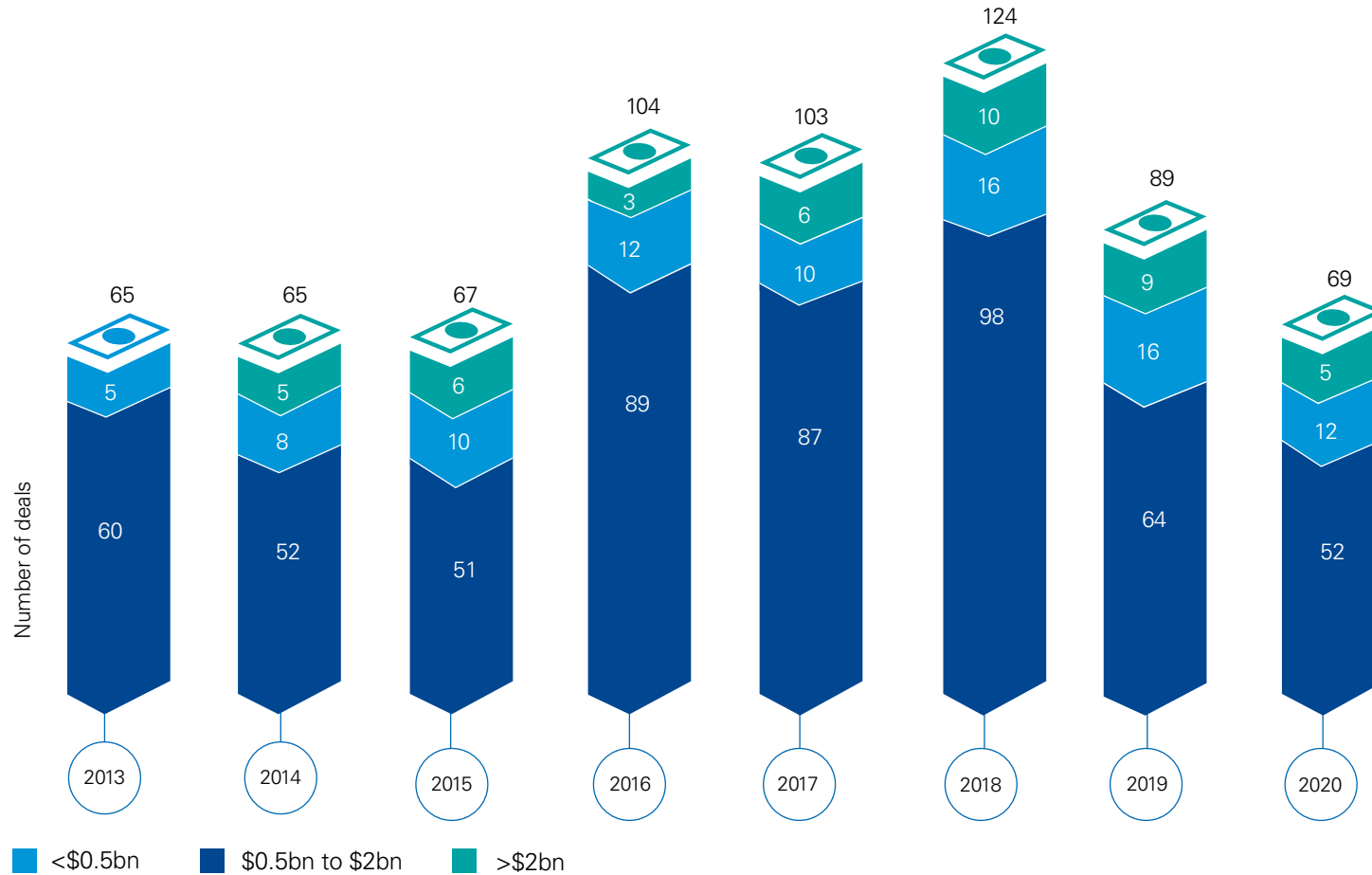
“With mounting federal debt levels and the extended period of depressed commercial air travel, there is likely to be a significant number of small and mid-market deals in the tier II and III segments.”

**Adil Khan**  
 Partner, Deal Advisory  
 Aerospace & Defense Sector Leader  
 KPMG in the US

Sources: Individual Company reports, press releases, CapIQ and Dacis

Companies are focusing on discretionary spending and cash conservation, so the appetite for risk has abated. In some cases, Buyers are shifting attention away from large transformational deals toward small to mid-sized strategically aligned transactions. This trend is likely to continue, as the market outlook will remain challenging and there will be increased regulatory scrutiny under the Biden administration and around the world.

### Deal volume by average value of disclosed deals

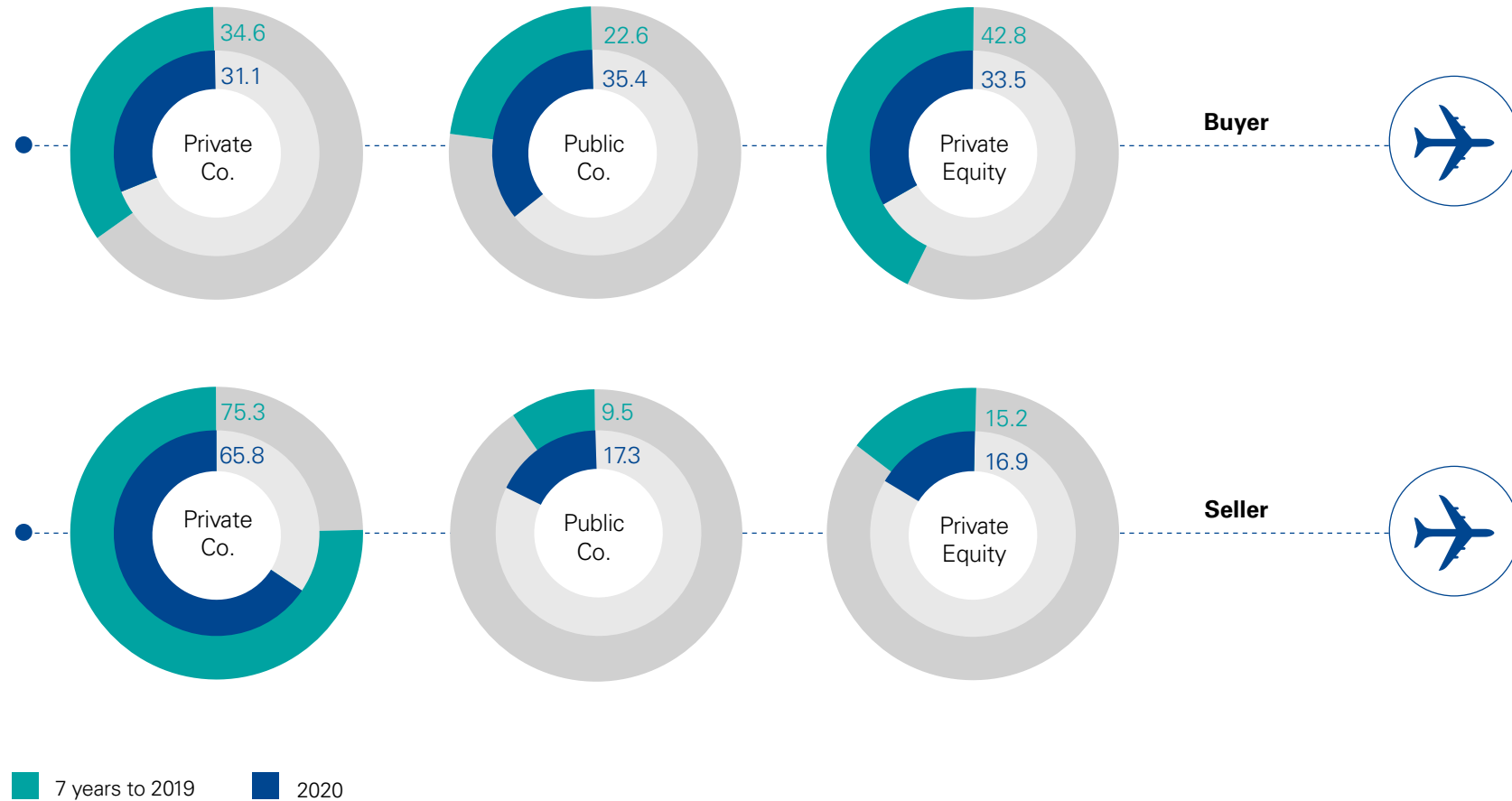


Sources: Individual Company reports, press releases, CapIQ and Dacis

Following the brief pause in M&A in the second quarter of 2020, financial sponsors have led the recovery in M&A volumes, as they pursue roll-up strategies powered by large amounts of capital that were raised before the pandemic struck.

### Private equity leads the buyers

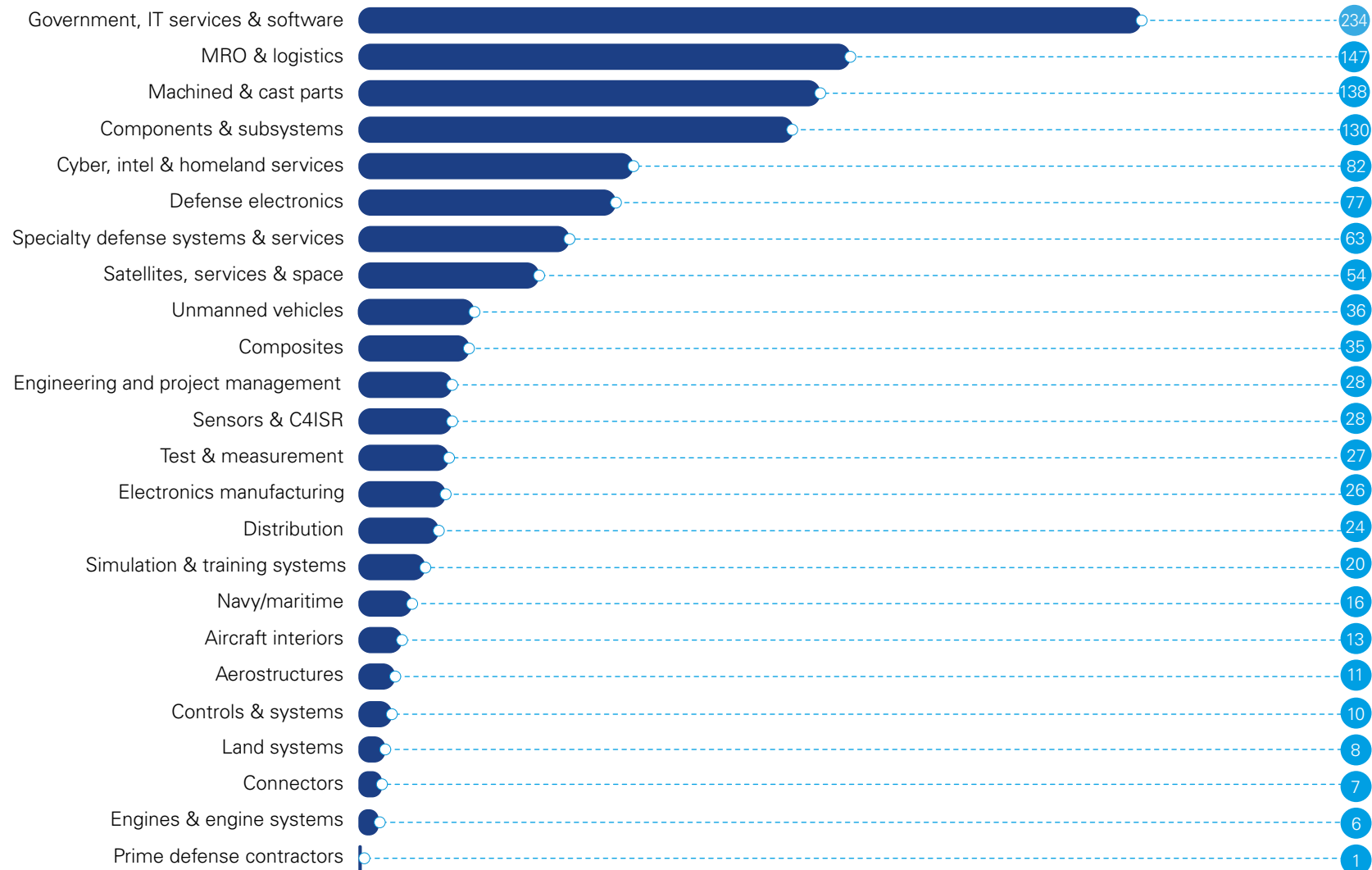
M&A volume share (%) by buyer/seller type



Sources: Individual Company reports, press releases, CapIQ and Dacis

Recent M&A activity is leading to consolidation in some of the highly fragmented segments, such as government IT services, MRO and machined components providers. Horizontal and vertical integration plays are focused on tier II and III suppliers. Primes/OEMs are acquiring innovative know-how through tuck-ins and SPAC mergers of next-gen technology providers that are positioned to take advantage of rapidly growing markets.

### Number of M&A deals by A&D segment in 3 years to 2020



Sources: Individual Company reports, press releases, CapIQ and Dacis

# The way forward

## The way forward

“With the lack of reliable projections, it is nearly impossible to form a credible view on valuations, let alone bridge this gap,” says Adams. “US public companies would likely weigh the benefits of share-buy-back strategies to take advantage of attractive price points against deploying capital toward M&A.”

Despite the uncertainty, however, there appears to be early signs in the M&A market of the recovery that is expected to begin in 2021. In the final two months of 2020, there was a surge of deal activity in the A&D sector, accompanied by reports of multiple bidders for certain companies and a growing number of offers for others. Lockheed Martin’s acquisition of Aerojet Rocketdyne for US\$4.4 billion, announced in December 2020, is an example of the renewed activity. Aerojet is providing the primary propulsion for both Lockheed’s and Boeing’s entrant to build a next-generation missile defense interceptor for the Pentagon.<sup>7</sup>

## The future of consolidation

The pandemic has left a large number of Tier I, II and III suppliers on financial life-support in many of the

major markets. These have received financial help from government-backed loan facilities and from large primes. Yet, it seems only a matter of time before many of these suppliers are consolidated to reduce capacity, in line with lower demand, and to gain greater access to capital. “The liquidity crush among the supply base is acute and may accelerate vertical re-integration,” Adams says. “The number of mergers will accelerate as lower-tier suppliers join together to create economies of scale and gain access to more capital.”

The challenge is that, in several countries, the A&D industry has a ‘hollow middle’: a few large primary contractors, many small companies with annual revenues under US\$100 million, and little in between. The French aerospace industry, for example, has more than 400 small suppliers, many within the ecosystem of Airbus. The French Aerospace Industries Association (GIFAS) is pushing hard to reduce this number. Germany is in a similar position with many of the smaller concerns family-owned. In the less sizeable market of Australia, there are two dozen system integrators and thousands of smaller businesses, says Mike Kalms, KPMG in Australia.

“There is a view that civilian aerospace M&A in France has touched bottom and that there will be a wave of industry consolidation in the trough. At the moment, however, every aerospace manufacturer in France sees itself as a buyer.”

**Stéphane Souchet**  
Global Head of Industrial Manufacturing  
KPMG International



## France outlook

The downturn in the A&D industry has exposed the strengths and weaknesses of France’s reliance on domestic manufacturers, some of which have in the past been supported by an industrial policy that consistently favored home-grown solutions to the country’s manufacturing needs. France’s emphasis on domestic manufacturing has resulted in too many small suppliers that can no longer compete effectively. The result is the country is likely to see an acceleration of consolidation, in which the weaker tier II and tier III suppliers may go out of business and the ones with advanced technology may be acquired by the bigger manufacturers. This process will be encouraged by the French Aerospace Industries Association (GIFAS) and the government, which will aim to minimize redundancies brought about by the restructuring.

<sup>7</sup> “Lockheed Martin buys Aerojet Rocketdyne in \$4.4bn deal,” Defense News, December 20, 2020



“There is a view that civilian aerospace within M&A in France has touched bottom and that there will be a wave of industry consolidation in the trough,” says Stéphane Souchet, KPMG in France. “At the moment, however, every aerospace manufacturer in France sees itself as a buyer, even those companies in financial difficulty.”

In 2020, the bankruptcy rate in France’s A&D was 40 percent lower than in the previous year because of the government’s state-guaranteed loans across the sector.

Worldwide, companies looking to acquire defense suppliers will need patience and vigilance to spot failing firms that are ripe for sale before others do, says Kalms. “In Australia, you would have to do several subscale acquisitions to achieve critical mass, so a roll-up is risky,” he says. “The targets have their own distinctive culture and sometimes unusual leadership styles and ownership structures.”

Private equity has been a significant player in the consolidation of aerospace supply chains in the US, and there is a good chance it can replicate that success in the defense supply-chain arena, too. OEMs will not necessarily drive consolidation in their own supply chains, which creates opportunities for longer-term PE funds that have significant amounts of financial capital. PE can play a big role in bringing similarly

competitive supply chain activity to Europe, if built into a pan-European platform. But the fragmented nature of the European market means that scalability may be a challenge if a PE house were to repeat the success of Blackstone’s involvement in MB Aerospace and Carlyle’s in Paradigm.<sup>8</sup>

### More diversification

Consolidation is not the only trend that is likely. Some companies will try to reduce their reliance on commercial aviation by means of M&A. Aerospace companies with feet in both camps, civilian and military, will be relying on their business in the latter sector to help them through the next few lean years. Some will want to diversify further and acquire more defense-manufacturing assets to increase their exposure to the military market.

In France, diversification is a good strategy, if companies can afford to do so. There, defense manufacturers have for decades avoided relying solely on military contracts, because the market is so narrow and product cycles so long. “French officials encourage defense companies to diversify, and many of them have invested in areas such as railways, urban mobility, and environmentally sustainable products,” says Souchet.

“  
In Australia, companies that have spread their activities across aerospace, defense, space and emergency services are highly regarded by Australians and can expect to hire people from among the best and brightest.”

**Mike Kalms**

Partner in Charge, Operations Advisory  
KPMG Australia



## Australia outlook

The A&D sector in Australia is ripe for restructuring and M&A is likely to play a significant part in accelerating this trend. As in some other countries, Canberra’s defense policy has focused on a high degree of self-sufficiency, which has led to an industry dominated by a few large manufacturers and a lot of small companies with few in-between. The implication is that Australia’s A&D market is likely to go in two directions: faster consolidation among small suppliers and an intensified search for new markets beyond Australia and outside pure defense, such as satellites and emergency services. Both of these trends are expected to lead to an increase in M&A activity.

<sup>8</sup> “Carlyle’s Dynamic Precision Group acquires Paradigm,” PitchBook, February 3, 2013

In smaller markets, such as Australia's, Kalms advises companies to look beyond both aerospace and defense, to space projects and emergency services, which require technologies such as artificial intelligence, 5G communications networks and robotics. "Australians have learned to be ready to deal with multiple natural crises, such as bushfires and drought, each year. Companies that have spread their activities across aerospace, defense, space and emergency services are highly regarded by Australians and can expect to hire people from among the best and brightest," he says.

## Going home

The vulnerability of far-flung supply chains to disruption is leading A&D companies to bring back onshore some of the key links in their supply chains. One country for which domiciling is a key objective is India, the world's third-largest military spender and the second-largest importer of defense equipment. Given that 70 percent of India's arms are imported, there are not enough assets in the country to attract any sizeable M&A activity involving foreign companies, says Gaurav Mehndiratta, KPMG in India. But greenfield ventures are more likely with India recently increasing automatic FDI from 49 percent up to 74 percent," he says, "in concert with their local partners."

Primary contractors such as Lockheed Martin, Boeing, MBDA, Thales, and Dassault, already have joint ventures in India and may be expected to raise their stakes at some point. They are attracted by the prospect of the government's target of spending US\$223 billion on armaments for land, sea and air in the next 10 years. Mehndiratta's advice to large OEMs is to have their memorandum of understanding in place and begin to show some manufacturing capability in India, while pushing tier I and II suppliers to plan to invest there.

"Foreign companies say they are watching to see what deals are made before making investments," says Mehndiratta. "Already deal activity is picking up a little among medium-sized Tier I and II suppliers and this segment is where we expect the money to flow in the next 2 to 3 years." In parallel, Indian OEMs are also eyeing niche defense technologies. Recently, the Tata Group acquired the IP rights for a German-origin platform to make an 'indigenous military aircraft'.

Valuations are in the single-digit EBITDA range, because foreign companies are unsure whether the government will follow through on its buy-in-India policy. "Companies are concerned that if there is an urgent need for armaments, they will go through government-to-government route and continue to import," he says. The government has also laid out an ambitious target in the draft Defense Production and Export Promotion Policy

to double the domestic procurement from the current US\$9.5 billion to US\$18.7 billion by 2025. Therefore, key future procurements are likely to be concluded with Indian vendors manufacturing domestically.

Mehndiratta's advice to foreign defense contractors is to start building a service capability right away, with a plan for establishing manufacturing capabilities in the near future. Some OEMs' tier I suppliers already have technology centers that design such things as aeroengines, but the largest opportunity would be if the entire supply chain for a particular product were to move to India, says Mehndiratta. "That would be the biggest game changer." By contrast, "the biggest risk would be to sit on the sidelines and not make an investment," he says.

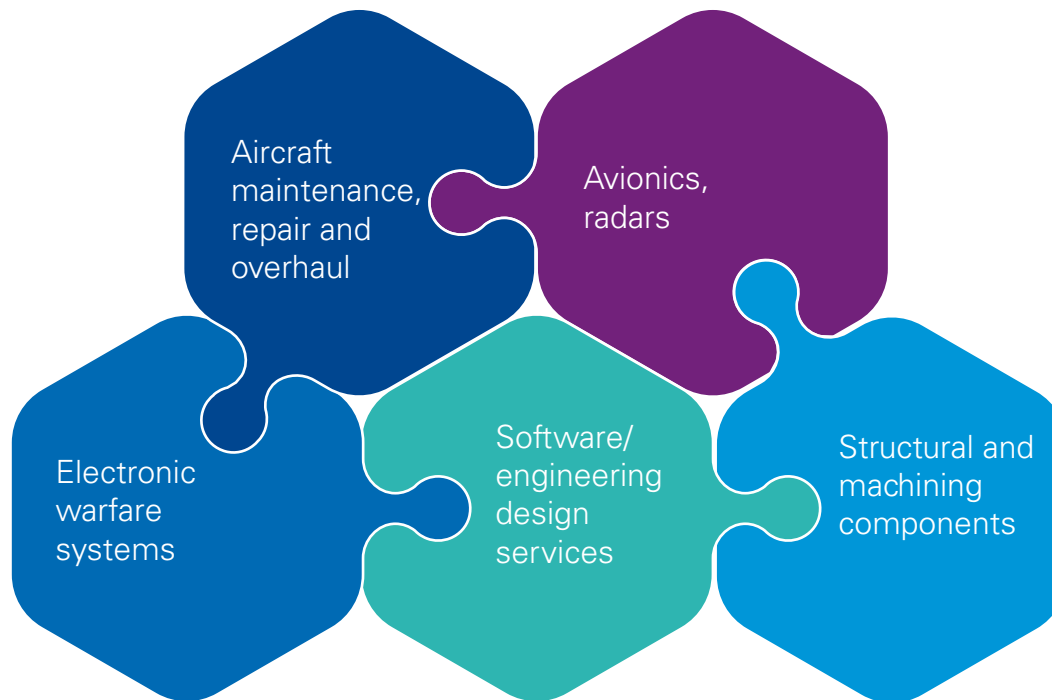
Potential areas in India for investment include: aircraft maintenance, repair and overhaul; avionics and radars; structural and machining components; software/engineering design services; electronic warfare systems.



## India outlook

The future of India's A&D industry is expected to be shaped by the government's decision in 2020 to reduce its reliance on imported defense systems, after a reassessment of the country's vulnerabilities in light of the growing military strength of China. India traditionally imported almost three-quarters of its defense equipment, but this is seen in Delhi as an increasing liability, particularly in the wake of the disruption to the global supply chain caused by the pandemic. In the long term, this will lead to M&A opportunities in the sector, but for now, the focus is on investment in greenfield ventures, many of which may combine India's expertise in software technology with foreign capabilities in hardware manufacturing. In the next 2 to 3 years, investment is expected to flow into mid-segment tier I and tier II suppliers, as foreign manufacturers cautiously size up India's market potential.

## Potential areas in India for investment



“

In India, the largest opportunity would be if the entire supply chain for a particular product were to move there. That would be the biggest game changer. The biggest risk would be to sit on the sidelines and not make an investment.”

**Gaurav Mehndiratta**

Partner and Head, Aerospace and Defense  
KPMG in India



## UK outlook

M&A deals in Britain's A&D industry are expected to intensify, as companies continue to adapt to the implications of Brexit, which went into full effect at the beginning of 2021. The British government plans a moderate increase in defense spending and a tightening of protection for domestic defense and space industries from potentially hostile foreign influence. Defense policy is emphasizing a bigger global role for UK defense, while aiming to strengthen existing supply chains, particularly between Britain and the rest of Europe. New investment and M&A deals are likely to focus on building technological capabilities in areas such as cyber warfare and satellites. Tighter government regulations on investment in A&D are unlikely to hinder companies from deepening international collaboration on new A&D systems.

### Activist governments

In response to heightened geopolitical tensions, governments have been taking an active role in shaping their domestic defense industries, both by supporting companies in various ways and by tightening their supervision of foreign investments in the sector. In the US, the Pentagon launched its Trusted Capital Marketplace in 2020 to connect companies critical to the defense industrial base with trusted capital and capability providers that have been vetted by the Defense Department. "Without this funding, capability providers in the DoD supply chain become susceptible to strategic funding from adversaries that leverage capital to exploit technology transfer," the Pentagon says.<sup>9</sup>

"The German government is willing to become an investor to help shape the industry and consolidate it at a Europe-wide level," says Kai Andrejewski, KPMG in Germany. "This will enable the private sector to place their assets with the government to further that effort." An example is that in December 2020, the German government reportedly<sup>10</sup> bought from KKR, the US private equity firm, a 25.1 percent stake in defense electronics company Hensoldt, which was formerly part of Airbus.

This change in Germany's approach will create opportunities for US companies, as well as European ones. US players are likely to include PE firms as well as defense contractors, says Andrejewski. France and Germany will probably want to strengthen defense ties with the Biden administration, both at a political and a business level.

“ I expect the market for cross-border deals in A&D will be extremely large and that technology advances will bring in new players to the sector that extends to space defense. ”

**Jonathon Gill**  
Head of Defense, KPMG in the UK

“ The UK aerospace supply chain remains highly fragmented and in light of the structural changes arising from COVID, there is clear need for consolidation to give the supply chain the resilience and scale of production capability, engineering, management and financing that is needed for the UK supply chain to be competitive on the global stage. The challenge to this remains identifying the consolidators, private equity or existing suppliers, and those willing to make the long term investments required. ”

**Glynn Bellamy**, M&A Partner, Aerospace, KPMG in the UK

<sup>9</sup> Trusted Capital program guide, Office of the Under Secretary, US Department of Defense, 2020

<sup>10</sup> "Germany decides to buy 25.1% stake in defence supplier Hensoldt - source," Reuters, December 16, 2020



## Germany outlook

The German government has traditionally taken a cautious approach toward shaping A&D industrial policy, but this has shifted in the wake of the economic downturn and the decision to reduce reliance on the US defense umbrella. There are signs that the government will invest directly in some smaller A&D companies that supply crucial technologies to the sector, such as electronics and avionics, while promoting co-operation among European manufacturers on future defense systems. This does not mean that US companies will be frozen out of future collaboration, because their advanced technology will be welcomed on a case-by-case basis. Much of the focus of industrial restructuring is likely to shift to the future of Airbus and the possibility of separating the defense business from the civilian one. This may lead to a number of M&A opportunities in Germany and elsewhere.

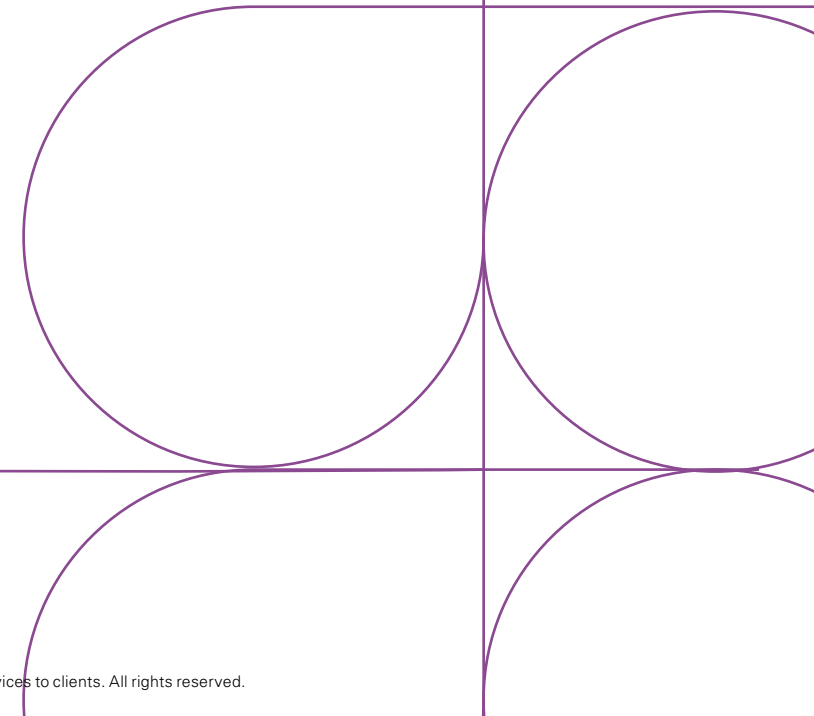
In the UK, the government has introduced new legislation (currently passing through Parliament) called 'The National Security and Investment Bill' that aims to introduce a new regime for reviewing and intervening in business transactions, such as takeovers, that might raise national security concerns. "I expect the market for cross-border deals in A&D will be extremely large and that technology advances will bring in

new players to the sector that extends to space defense." Jonathon Gill, KPMG in the UK, believes that, in future, more collaboration will be needed between friendly governments and business to manage the enormous costs of launching new defense systems in the wake of programs such as the US\$400 billion development/procurement of the Lockheed Martin F35 joint strike fighter.

“

The German government is willing to become an investor to help shape the defense industry and consolidate it at a Europe-wide level. This will enable the private sector to place their assets with the government to further that effort.”

**Kai Andrejewski**  
Regional Head of A&D  
KPMG in Germany



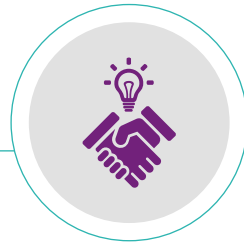
# Conclusion

## A turning point

This report provides an overview on how the next 3 years are likely to prove a turning point in the development of the market for M&A in A&D, as the long-term effects of geopolitical shifts, the global pandemic and digital transformation create opportunities and challenges for dealmakers and companies in the sector. As the market evolves, executives will need to consider the following strategies if they are to improve shareholder returns:



**Align investment plans** to the rapidly evolving business cases, as they arise. This means paying close attention to the impact and timing of shifts in demand for military equipment, changes in regulatory environment, technology advances, mission priorities, defense budgets and the long-term impact of remote working.



**Explore innovative deal structures** including option-based, seller notes, contingent or deferred consideration or loan-to-own arrangements.



**Use flexible valuation models** to compare a wide range of sensitivities and retest fundamental assumptions that drove value in the past but are unlikely to hold true any longer.



**Deploy advanced analytical techniques** to evaluate businesses and identify corporate opportunities. Traditional synergies may no longer fit the bill. Run a multitude of scenarios and analyze a wide and diverse array of information.

Companies that move quickly and decisively are likely to be rewarded as the M&A market heats up. This does not mean that executives need to cut corners; quite the opposite. The A&D industry will continue to be governed by policies to protect domestic manufacturers, which means that companies must be extremely prudent and politically savvy. But geopolitics and technological rivalry is changing the game. Governments are focusing on protecting their key sectors from potentially hostile industrial predators and, at the same time, are becoming more open-minded about cross-border industrial collaboration. This environment will provide a fertile ground for M&A opportunities in A&D for those companies that are careful, yet bold.

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