

Aerospace, Defense and Government Services

July 2019

Expect more deals in hot Aerospace, Defense and Government Services sector, experts say

JULY 2019

The consolidating aerospace and defense sector should continue to drive government services M&A in the South through 2019, particularly in Northern Virginia and Alabama, industry experts said. But geopolitical uncertainty could hinder that momentum in 2020.

In the first half of 2019, one USD 18.3bn deal closed, forming **L3 Harris Technologies** [NYSE:LHX], now the nation's sixth-largest defense contractor. **United Technologies** [NYSE:UTX] also announced its pending acquisition of **Raytheon** [NYSE:RTN], in a deal valued at just shy of USD 89bn, which would create the country's second-largest aerospace-defense company.

Consolidation among the largest players will push middle-market government services suppliers to build their technology via M&A, said Hogan Lovells partner Carine Stoick, who heads the firm's aerospace, defense and government (ADG) M&A group from Northern Virginia.

With this tailwind, Stoick expects transaction activity to continue to be strong throughout the rest of 2019. "There's also the whole government IT solutions industry which I think is booming in the Northern Virginia area," she said, noting heavy transaction volume involving companies involved with IT modernization.

Huntsville, Alabama, is also a key area with defense companies that are likely to consolidate, she said.

“This is as active as a market as we’ve seen,” said Mitchell Martin, a senior managing director of The McLean Group’s ADG practice. “If you look at things since 9/11, it peaked in about 2006/2007 both in terms of transaction volume and valuations, and that really directly tracks government spend and specifically deal spend at the time.”

Martin said a lot of that activity is tied together with an administration’s priorities, but that it also has to do with the entire market and where the public companies are trading.

Defense spending has increased under US President Donald Trump’s administration. But with rising macroeconomic tensions that include an ongoing US trade war with China and geopolitical instability in the Middle East, the resiliency of the hot M&A market is difficult to predict, said Elizabeth Donley, a partner at Hogan Lovells who works on cross-border M&A transactions.

However, uncertainty in the geopolitical environment creates an “interesting dynamic,” Donley said. It creates demand, which is good for the defense industry as a “boost,” she said, but the tensions and disruptions can also be a hindrance because it can make deals harder to get done.

Both Hogan Lovells attorneys agreed, 2019 should continue to see strong M&A activity, but come 2020, another US presidential election looms and that equals uncertainty.

“I don’t know if dealmakers are as optimistic that 2020 will look the same,” Stoick added. “But I do think for the rest of 2019 people feel very confident about M&A activity.”

Stoick said continued industry consolidation could pressure other large ADG companies to combine, and that could result in more small divestitures, something Martin also said could drive M&A in the middle market.

For the merger of L3 and Harris, the U.S. Justice Department stipulated Harris divest its night vision business for the merger to proceed, and in April Harris announced it would sell its night vision business to the US division of Israel’s **Elbit Systems** [NASDAQ:ESLT] for USD 350m.

by James Ward in Charlottesville, Virginia