Mission control
Second-quarter 2011 aerospace and defense industry mergers and acquisitions analysis
Welcome to the second-quarter 2011 edition of Mission control, PwC’s quarterly analysis of mergers and acquisitions (M&A) in the global aerospace and defense (A&D) industry. In addition to a detailed summary of M&A activity in the second quarter, this edition features a special report on the challenges companies are facing as they expand into regions around the world where corruption is pervasive. The A&D industry has always viewed corruption as a significant concern, and with the uptick in deal activities, companies are looking to mitigate the related risks. Meanwhile, anti-corruption initiatives are intensifying as governmental bodies and regulatory agencies prioritize the issue. However, through focused anti-corruption efforts, companies have the opportunity to balance compliance and growth to produce the best results.
Multinationals continue to speed global expansion through mergers and acquisitions, pursuing deal activity at a steadily increasing pace to fuel faster growth and hone competitive advantage. Yet organizations face intensified risks in regions where corruption is pervasive and corrupt practices are longstanding—even accepted as status quo at times. Globally, calls for increased anti-corruption initiatives are intensifying, as governmental bodies in the United States, the United Kingdom, India, Japan, and elsewhere ask their regulatory agencies to take a stronger stance. In the United States, the Securities and Exchange Commission (SEC) and Department of Justice (DoJ) are stepping up enforcement actions as mandated by the Foreign Corrupt Practices Act (FCPA), moving steadily through backlogged cases, and increasing criminal prosecutions, all with the potential to increase the personal exposure of C-suite executives to charges under FCPA, with some even facing imprisonment. Penalties, disgorgement of profits, and costs associated with monitoring for corruption risks are growing dramatically, too. The collateral financial damage is significant and climbing rapidly: FCPA enforcement actions increased 85% in 2010, with the DoJ and the SEC bringing a combined 74 actions, nearly doubling the tally of 40 enforcement proceedings in 2009. In addition, eight of the largest FCPA-related monetary settlements in history—ranging from $56.2 million to $400 million—occurred during that period.\(^1\) The largest penalty, at $800 million, was settled in 2008 (See table below). On top of this, bribes of more than $1 trillion are paid annually, with the cost of doing business globally increasing 10% per year on average because of corruption, according to the World Economic Forum.\(^2\)

<table>
<thead>
<tr>
<th>Top-10 FCPA settlements(^3)</th>
<th>Country</th>
<th>Year of penalty</th>
<th>US$ mil.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Siemens</td>
<td>Germany</td>
<td>2008</td>
<td>800</td>
</tr>
<tr>
<td>2 KBR/ Halliburton</td>
<td>US</td>
<td>2009</td>
<td>579</td>
</tr>
<tr>
<td>3 BAE</td>
<td>UK</td>
<td>2010</td>
<td>400</td>
</tr>
<tr>
<td>4 Snamprogetti Netherlands B.V. / ENI S.p.A</td>
<td>Holland/ Italy</td>
<td>2010</td>
<td>385</td>
</tr>
<tr>
<td>5 Technip S.A.</td>
<td>France</td>
<td>2010</td>
<td>338</td>
</tr>
<tr>
<td>6 JGC Corporation</td>
<td>Japan</td>
<td>2011</td>
<td>219</td>
</tr>
<tr>
<td>7 Daimler AG</td>
<td>Germany</td>
<td>2010</td>
<td>185</td>
</tr>
<tr>
<td>8 Alcatel-Lucent</td>
<td>France</td>
<td>2010</td>
<td>137</td>
</tr>
<tr>
<td>9 Panalpina</td>
<td>Switzerland</td>
<td>2010</td>
<td>82</td>
</tr>
<tr>
<td>10 Johnson &amp; Johnson</td>
<td>US</td>
<td>2011</td>
<td>70</td>
</tr>
</tbody>
</table>

The significant implications of successor liability, under which the purchaser assumes liability for past actions of the acquired company, are pushing companies to enhance their corruption due diligence programs to make sure they fully understand the risks of acquiring certain targets, determine whether red flags exist, and identify what post-acquisition compliance actions will be necessary. Corruption due diligence, a regulatory expectation, may result in purchase price adjustments. Organizations that fail to address these concerns before closing a deal face both significant financial loss and reputational risk; however, companies that embrace these compliance challenges can realize new opportunities for entry into markets they may have previously avoided.

The A&D industry has always viewed corruption as a significant concern, particularly during robust periods of M&A activity. These concerns are likely to remain top-of-mind for industry leaders given the $20.7 billion worth of deals in 2010 and the prognosis for further increase this

\(^1\)“2010 FCPA Enforcement Shatters Records,” Melissa Aguilar, Compliance Week, Jan. 4, 2011


year, resulting from continuing consolidation and major commercial and military manufacturers’ emphasis on gaining better control of their large program pipelines.

This recent uptick in deals presents opportunities as well as challenges. More than 14% of known international bribery enforcement activity between 1977 and 2010 involved companies in the aerospace, defense, and security industries, according to Trace International’s Global Enforcement Report 2010.

Enforcement agencies in the US have greatly expanded their prosecution of FCPA violations in the last year. The A&D industry, among others, is at increased risk for enforcement actions because the nature of the industry itself means companies must often deal directly or indirectly with governmental and quasi-governmental agencies. Other vulnerable areas include:

- Expansion of global M&A activity into the BRIC countries (Brazil, Russia, India, and China) along with some Asian, Latin American, and Eastern European countries
- Use of agents, distributors, lobbyists, and other third parties
- Regulatory issues
- Concerns regarding client entertainment, gifts, hospitality, and travel
- Unclear service and maintenance contracts
- Transparency with defense offsets
- Licensing, tax, and product registration issues
- Product certification

A&D companies often pursue deals involving multinational targets, joint ventures (at times, minority owned), or supply chains that may extend into markets where the risk of corruption is high—for example, aerospace companies either doing business in or outsourcing certain activities to China or India. Consequently, these organizations are allocating additional resources, including accounting and legal fees, to conduct compliance and fraud risk due diligence that extends even beyond FCPA reporting requirements. Consequently, A&D companies are paying closer attention to the risk-to-reward ratio. When the risk level is prohibitive, some organizations are passing up the opportunity, perhaps to pursue a small acquisition, even in those regions where expansion is potentially lucrative.

In the wake of a landmark year for anti-corruption enforcement, companies in a number of industries are concerned about several trends in the near term:

- The Dodd-Frank Act requirement to disclose all payments to foreign governments (applicable only to SEC registrants) could result in even greater scrutiny of anti-corruption issues.
- Foreign governmental bodies are amplifying anti-corruption enforcement, with the UK, Denmark, and Italy implementing and actively enforcing anti-graft legislation in 2010. Also affecting corruption is the number of countries that have signed on to the Organization for Economic Cooperation and Development (OECD) Anti-bribery Convention, and the United Nations Convention Against Corruption (UNCAC).
- International harmonization of anti-fraud and anti-corruption regulation will increase parallel investigations, likely resulting in more penalties.
- The number of FCPA cases and severity of penalties is expected to increase because of the growing backlog of investigations planned by the DoJ and the SEC.
- With anti-corruption compliance becoming a top corporate governance issue, companies will be burdened with the time and expense of devoting greater resources to anti-corruption initiatives.
- Corruption investigations will likely trigger shareholder litigation, tax investigations, money-laundering probes, and other adverse actions.
- Individuals will face increased scrutiny when regulators investigate potential violations of the FCPA and other anti-corruption legislation from around the globe.
Vetting third parties

Relationships with third parties, such as distributors, intermediaries, sales agents, dealers, and consultants, carry greater risk for companies that, because they are expanding globally, are subject to closer scrutiny. This is especially true for organizations pursuing deals in the BRIC countries and the Middle East, where it is often impossible to drive business without establishing relationships with other individuals or commercial entities. In fact, the BRIC countries received unfavorable ratings (from Russia, with a score of 2.1 to Brazil with a score of 3.7) on Transparency International's 2010 Corruption Perceptions Index, which is measured on a scale from zero (highly corrupt) to 10 (highly clean).  

Corruption Perception Index 2010

4 “Transparency International” www.transparency.org
A high percentage of the civil and criminal enforcement actions have stemmed from the activities of third parties—those new to the acquirer as well as those with longstanding relationships with the acquirer. There is also the risk posed by third parties that have been adequately vetted themselves, but that use their own third parties that may not have been thoroughly scrutinized. Corruption issues often stem from third parties making direct or indirect payments that violate bribery and corruption laws or statutes around the world. These payments, which in some countries are viewed by locals as just “the cost of doing business,” typically are recorded as professional, consulting, commission, service, or selling expenses. Companies that successfully mitigate corruption risks begin by gaining a complete understanding of the third parties they are engaging and the business models of those organizations. Further, they include compliance clauses in contracts and maintain their third-party contracts in a central location. Additionally, these organizations implement robust processes to periodically assess key business partners and monitor activities and transactions associated with such relationships, and provide third parties with training on compliance policies.

**Determining the appropriate level of due diligence**

Companies pursuing corruption due diligence activities during acquisitions typically rate targets and their affiliated third parties on their potential risk based on a variety of factors, including geographic regulation, the focus of regulators from an industry standpoint, and the size of the transactions with which they have been involved or will be involved. In addition to the complexities inherent in the activities are the challenges regarding the depth and intensity of due diligence proceedings that support any particular transaction. Organizations are carefully evaluating how many resources should be devoted to a single case, in terms of labor and financial commitment. What if bribery or other corrupt practices are discovered after a deal closes? Can a company protect itself from enforcement actions at that point? How much due diligence is enough?

**Navigating disclosure requirements for conflict minerals**

In the wake of the conflict minerals provision of the Dodd-Frank Act, the SEC is expected to issue the rule and disclosure requirements by fourth-quarter 2011. Companies representing multiple subsectors across the industrial products spectrum are already performing due diligence to determine whether their supply chains include conflict minerals, defined by the OECD as “key minerals from conflict-affected and high-risk areas.” Some companies, expecting the list to expand, are also preparing their supply chain for minerals beyond columbite-tantalite (coltan), cassiterite (tin), wolframite (tungsten), and gold. Companies looking to expand in Central Africa or pursue M&A with organizations that source these minerals from affected countries must determine the “reasonable” level of due diligence for their supply base where mineral transparency has yet to be established.

Companies seeking to mitigate risk in this area are examining internally across operations, or asking their extensive supply bases about any mineral presence in subcomponents or products provided. Effective strategies could include enhancements of the existing supply chain program, leveraging knowledge of the supply base on hand, and reactivating communication and reporting channels already in place with suppliers.

The downside for not heeding conflict minerals restrictions (including the FCPA requirements) includes huge potential for enforcement actions and significant reputational damage. For example, watchdog organizations and media critics were quick to disparage companies whose mineral sourcing benefited armed groups in the Democratic Republic of the Congo (DRC) and surrounding countries. Consequently, a few companies may be assessing options for alternate sourcing and examining competitors’ business models for alternatives. Factors likely to be considered in the process include cost, performance, mineral compositions and quality, logistics, new supplier verification concerns, and the issues associated with developing a new business model.

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5 “New disclosure requirements for ‘conflict minerals’ and pressure on compliance, reputation, and competitiveness,” PwC, April 2011
Strategising to mitigate corruption risks

Companies achieving success in anti-corruption efforts take a focused approach to the task. They strategize to balance their compliance and growth, and allocate resources to the efforts that will produce the best results. Steps include:

• Centering near-term compliance efforts on FCPA regulations, which represent the core international criminalization and enforcement standards. By strictly adhering to FCPA guidelines, organizations can more easily come into compliance with other regulations, such as export laws, and be better prepared for upcoming global compliance initiatives.

• Building proactive, more transparent information sharing among the risk, operations, finance, and corporate development functions.

• Carefully monitoring and testing accounts to discover financial discrepancies and determining whether to voluntarily disclose them to regulators.

• Educating employees on international anti-corruption standards, developing robust training programs, and routinely field testing company compliance rules.

• Performing forensic due diligence on potential third parties—including suppliers, joint venture partners, agents, and local representatives—to inform business strategy with respect to new and potentially risky opportunities.

• Collaborating with anti-corruption bodies and nongovernmental organizations to continually monitor global corruption risk, identify potential opportunities in untapped markets, share anti-corruption practices, and foster international cooperation across the public and private sectors.

Some observers paint ongoing, robust international anti-corruption efforts as obstacles that have created an uneven and costly global playing field for US companies, reinforcing the barriers to entry in potentially lucrative markets. But other observers view these initiatives as having a positive global influence. During this era of dramatically increased enforcement and heightened awareness about the pitfalls and collateral damage associated with corruption, other countries around the world are following suit, committing to global anti-corruption standards and actions.
Perspectives: Thoughts on deal activity in the second quarter of 2011

Second quarter deal flow in the global A&D sector was down compared with the very robust first quarter, though US entities have become more active. The $5.3 billion of deals in the second quarter is consistent with the level of activity throughout 2010. However, we still see increased activity in the market. And while it is difficult to predict when deals will close, we believe activity in the second half of the year will likely be above second quarter levels with a chance that the full year 2011 totals will approach the record levels of 2007.

A hallmark of recent sector M&A has been the trend of sector constituents divesting lower-growth defense businesses, illustrated by Northrop Grumman’s $2 billion spinoff of Huntington Ingalls, which was initiated because of expected lower spending on Navy ships. Divestitures, defined as the loss of control of a target by a parent company, rose in the 2011 second quarter compared with the first quarter and 2010. Investor emphasis on deployment of capital is likely to lead to more of these transactions. For example, ITT plans to spin off several units, including its defense business, later this year. And on July 28, L-3 Communications announced the spin-off of some government services businesses.

Strategic investors are using this period of restrained defense budgets to focus on areas they believe are more resistant to spending pressures, such as unmanned systems and cyber-security. These buyers are well positioned to enter into deals for these targets as our benchmarking indicates that the largest A&D companies continue to add to their cash stockpiles. Financial acquirers became more active this quarter, with many acquiring defense services companies. These targets can provide financial investors with relatively steady cash flow and there is little competition from strategic investors for these deals.

A&D deal valuation remains low by long-term historical standards even when adjusting for the higher multiples reported during the leverage bubble. Disclosed multiples for defense-oriented targets have also been generally lower than multiples for commercial aerospace-oriented targets. While defense multiples may remain low because of the relatively slower growth expectations in this part of the sector, we expect median A&D sector valuation to gradually improve, primarily driven by interest in commercial aerospace targets. Emerging market acquirers, particularly in the BRIC countries, have become more active. Most of these deals have acted to consolidate local aerospace industries; however, the overall trend toward more cross-border deals is notable. We expect this trend to continue as interest in the US defense market provides the impetus for additional cross-border transactions.

While deal totals were down sequentially during the second quarter, we continue to expect growth in aerospace and defense M&A activity. Defense companies continue to reshape portfolios while commercial aerospace is booming and very attractive for investors, capital markets are generally receptive, and cash positions continue to increase. These factors support our positive outlook for A&D deals in second half of 2011.
Quarterly aerospace and defense deal activity
Measured by number and value of deals worth $50 million or more (3Q08-2Q11)

<table>
<thead>
<tr>
<th>Year</th>
<th>3Q</th>
<th>4Q</th>
<th>1Q</th>
<th>2Q</th>
<th>3Q</th>
<th>4Q</th>
<th>1Q</th>
<th>2Q</th>
<th>3Q</th>
<th>4Q</th>
<th>1Q</th>
<th>2Q</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008</td>
<td>9</td>
<td>5</td>
<td>5</td>
<td>10</td>
<td>11</td>
<td>10</td>
<td>10</td>
<td>13</td>
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<tr>
<td>2009</td>
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<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>2010</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>2011</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
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<td>0</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

Number of deals
Total deal value ($ billion)
Average deal value ($ billion)

Deal activity during the second quarter declined somewhat from the first quarter. However, this appears to be more of a result of the robust nature of M&A activity during the first quarter than the start of a new long-term trend. In fact, announcements during the second quarter compare favorably with quarterly M&A totals during most of the recent deal recovery of 2009 and 2010.
The past quarter also resembled 2010 when considering the level of activity by US entities. Deal makers in the US accounted for a greater proportion of both deal volume and deal value. The latter is due to the Tognum AG announcement, which accounted for almost half of announced deal value during the first quarter. Accordingly, our conclusion is that the first quarter was an outlier in many ways, and the second quarter resembles a more normalized pattern of growth following the 2009 M&A trough.

Average deal values also seem positioned to resume their rise, driven by the strong long-term outlook in commercial aerospace.
Aerospace and defense deal valuation remains low by historical standards. In fact, the median value/sales for deals announced so far in 2011 is near a 10-year low; a similar pattern appears when examining value/EBITDA multiples. This trend is likely to reverse as the overall level of M&A activity continues to improve. For example, valuation has historically tended to increase during periods of greater total deal value. Higher values and valuation can sometimes reflect the higher competition for targets during these periods. However, this relationship was most pronounced during the recent leverage bubble, an environment that is unlikely to appear again soon. We are likely to see the increase driven by commercial aerospace, while defense valuations may be somewhat suppressed.
In previous editions of *Mission control*, we’ve stated our expectation that A&D competitors would increasingly turn to divestitures in order to focus their business portfolios on a smaller set of defense spending priorities. And this indeed was the case, as divestitures accounted for the majority of deals announced during the first half and second quarter.

Financial investors were more active this quarter and leveraged buyouts increased. The most prominent deal with these characteristics was the largest announcement of the quarter, the $1.8 billion leveraged buyout (LBO) of SRA International by Providence Equity Partners. Financial acquirers in this sector have recently focused on defense services targets. However, it is noteworthy that these parties also played a significant role in advocating for major changes to conglomerates with defense businesses, such as ITT. Investors are likely to continue to push for spin-offs of underperforming defense businesses, which should drive additional M&A activity. Financial buyers are also likely to be active buyers of the businesses that sector constituents are seeking to shed, assuming that these targets fit well with current competencies. For example, Fortress Investment, which already has an interest in aircraft lessor Aircastle, recently agreed to purchase BAE Systems’ aircraft leasing unit for $187 million.

While financial investors are likely to increase the activity in the sector, strategic investors continue to move quickly to increase their already ample liquidity positions. Weak defense spending trends coupled with pressures to use this cash or return it to shareholders should lead these companies to seek more M&A opportunities.
## Summary of mega-deals

### Mega-deals in 2010 (deals with a disclosed value of at least $1 billion)

<table>
<thead>
<tr>
<th>Month announced</th>
<th>Target name</th>
<th>Target nation</th>
<th>Acquirer name</th>
<th>Acquirer nation</th>
<th>Status</th>
<th>Value of transaction in US$ bil.</th>
<th>Category</th>
</tr>
</thead>
<tbody>
<tr>
<td>Feb</td>
<td>VT Group PLC</td>
<td>United Kingdom</td>
<td>Babcock International</td>
<td>United Kingdom</td>
<td>Completed</td>
<td>2.00</td>
<td>Ship Building &amp; Repairing</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Group PLC</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mar</td>
<td>Vought Aircraft Industries Inc</td>
<td>United States</td>
<td>Triumph Group Inc</td>
<td>United States</td>
<td>Completed</td>
<td>1.57</td>
<td>Aircraft &amp; Parts</td>
</tr>
<tr>
<td>Sep</td>
<td>McKechnie Aerospace</td>
<td>United States</td>
<td>TransDigm Group Inc</td>
<td>United States</td>
<td>Completed</td>
<td>1.27</td>
<td>Aircraft &amp; Parts</td>
</tr>
<tr>
<td>Sep</td>
<td>L-1 Identity Solutions Inc</td>
<td>United States</td>
<td>Safran SA</td>
<td>France</td>
<td>Pending</td>
<td>1.13</td>
<td>Computer integrated systems design</td>
</tr>
</tbody>
</table>

### Mega-deals in 1H11 (deals with a disclosed value of at least $1 billion)

<table>
<thead>
<tr>
<th>Month announced</th>
<th>Target name</th>
<th>Target nation</th>
<th>Acquirer name</th>
<th>Acquirer nation</th>
<th>Status</th>
<th>Value of transaction in US$ bil.</th>
<th>Category</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mar</td>
<td>Tognum AG</td>
<td>Germany</td>
<td>Engine Holding GmbH</td>
<td>Germany</td>
<td>Pending</td>
<td>4.84</td>
<td>Internal combustion engines, nec</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Jan</td>
<td>Huntington Ingalls</td>
<td>United States</td>
<td>Shareholders</td>
<td>United States</td>
<td>Completed</td>
<td>2.01</td>
<td>Aircraft &amp; Parts</td>
</tr>
<tr>
<td></td>
<td>Industries Inc</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Apr</td>
<td>SRA International Inc</td>
<td>United States</td>
<td>Providence Equity Partners LLC</td>
<td>United States</td>
<td>Pending</td>
<td>1.79</td>
<td>Computer facilities management services</td>
</tr>
</tbody>
</table>

First-half mega-deals, defined as deals with a disclosed value of at least $1 billion, are on pace to exceed that of 2010. The largest 2011 deal was a sweetened tender offer from Engine Holding, a joint venture between Rolls-Royce and Daimler, for Tognum AG. Tognum sells industrial, marine, and military vehicle engines. Rolls-Royce plans to transfer its Bergen ship engine and power generator business to Tognum.

The second-largest mega-deal announced this year was Northrop Grumman’s completed spinoff of its Huntington Ingalls shipbuilding unit. A weaker outlook for US shipbuilding contributed to Northrop Grumman’s decision to spin off this business. As a standalone company, Huntington is now attempting to restructure its operations, including the potential closing of its Avondale shipyard.

The year’s third mega-deal, which was announced this quarter, was the $1.8 billion Providence Equity Partners’ announced LBO of SRA International. SRA started looking for a buyer late last year, and Providence Equity was considered a good match for SRA given the links between management of the two companies (a former chief executive of SRA joined Providence as a senior adviser in 2010).

The trend of large strategic buyers narrowing their focus on businesses that are believed to be more resilient to defense spending cuts appears to be creating opportunities for financial investors. This is contributing to financial buyer acquisitions in government services, including mega-deal announcements. These financial buyers should continue to find attractive investment opportunities in these firms, which tend to have relatively stable cash flows from longer-term government contracts. Large strategic buyers are also likely to continue to shift from diversified strategies and toward building competencies in specific defense niches, which could drive additional mega-deals.
Deals involving North American parties increased and entities from Asia and Oceania were less active during the second quarter. These trends unfolded as acquisitions from emerging and developed investors increased. The majority of deals announced this year by acquirers from emerging and developing countries involved BRIC companies consolidating their local commercial aerospace industries. This is in line with previous expectations that countries like China would focus on building domestic commercial aerospace capabilities. However, going forward, entities from these countries are likely to look off shore more often to acquire new technologies (to the extent allowable from a regulatory standpoint).

* Deals by acquirer region chart does not include one deal in South America during 1H11 and 2Q11.

** Deals by target region chart does not include one deal in the Africa/Undisclosed region during 10-year historical period and one deal in South America during 1H11 and 2Q11.
During the first half of 2011, cross-border deals increased slightly, though these deals are mostly driven by acquirers from advanced economies. Several of these cross-border deals targeted US defense companies. This is in keeping with our earlier expectations that, despite pressures on US defense spending, the overall size of this market would continue to attract foreign buyers. This trend should continue as large foreign constituents, such as EADS, maintain their reported interest in US A&D companies.

Though the overall market has moved toward more cross-border activity in recent periods, several factors support a continued interest in local-market transactions. These include the desire of some emerging markets to build their domestic aerospace industries and efforts by several developed countries to restructure their defense industrial bases.
Acquirers from advanced versus emerging and developing economies
Measured by number of announced deals worth $50 million or more

Global aerospace and defense deals in first-half 2011
Measured by number and value of deals worth $50 million or more

North America
Local—10 deals, $5.7 billion
Inbound—6 deals, $1.8 billion
Outbound—3 deals, $1.2 billion

South America
Local—1 deal, $0.5 billion

Europe
Local—6 deals, $5.6 billion
Inbound—3 deals, $1.2 billion
Outbound—6 deals, $1.8 billion

Asia and Oceania
Local—4 deals, $0.3 billion
With increasing global M&A activity comes an uptick in reputational and business risks, as more and more business takes place in emerging and expanding markets. Adding to the challenges organizations face in their global business operations is the dramatic rise in US and international regulatory enforcement actions—in some cases including multimillion-dollar and billion-dollar fines and settlements, and in some cases, even imprisonment for executives. Consequently, corruption due diligence has become a high priority, an essential area of emphasis for organizations seeking to achieve the desired results of M&A transactions and maintain business continuity. By effectively understanding, addressing, and resolving important concerns about corruption, companies can develop a strong anti-corruption program that embraces the demands of both compliance and growth. The viability of conducting business in any given region can hinge on how effectively companies prepare for anti-corruption compliance and geopolitical risk.

**How PwC can help**

PwC’s global network of seasoned professionals has the experience, knowledge, and reach to help clients navigate and integrate all phases of regulatory compliance. The goal is to help organizations design, implement, evaluate, and monitor the effectiveness of their anti-corruption programs. PwC helps companies:

- Understand the full range of international anti-corruption frameworks, monitor the extent to which emerging policies are being implemented and enforced around the world, and assess their potential effects on business strategy
- Gain a better understanding of corruption to compete more effectively, make better decisions, and enter new markets
- Issue clear company policy on what constitutes unacceptable behavior and enforce the prescribed consequences
- Perform a risk assessment of existing operations to support compliance and monitoring programs
- Mitigate bribery concerns by maintaining transparent, well-tested systems and policies
- Streamline payment systems and controls so organizations can easily view where, why, and how much money is being spent and eliminate unexplained, insufficiently detailed, or falsely characterized payments
- Regularly test payment systems and controls to ensure expenditures are accounted for at all times
- Perform ongoing due diligence on the business partners, personnel, and contracts involved in a new-market expansion, thereby mitigating business, reputational, and regulatory risks
- Conduct thorough, annual training to help employees address the effects of international anti-corruption standards
- Perform frequent field tests to determine whether employees understand compliance policy

With a global presence in more than 150 countries, PwC has local perspective and depth, in addition to professionals highly qualified in due diligence, forensics, and analytics to help mitigate risk in business transactions. PwC offers:

- A thorough understanding of local and regional culture, language, financial, and regulatory systems
- An international network of partners and staff who offer a unilateral advantage in assessing issues that extend across borders and the ability to provide our clients with true global reach in a coordinated and expedited manner
- The knowledge of qualified investigators who have held senior positions with or have extensive experience working with major prosecutorial and law enforcement agencies in the United States, Canada, the United Kingdom, Europe, South Africa, and Asia

Most companies have anti-corruption programs. Yet only 22% of executives recently surveyed by PwC said they were confident they could effectively identify and mitigate corruption risk. More than half reported that a stronger understanding of corruption would help them compete more effectively and enter new markets.

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4 "Confronting risk in business relationships and emerging markets," PwC, 2009
### A&D company case study:
An A&D company conducts anti-corruption due diligence on a target company with operations in Asia

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<th>Issue</th>
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<td>In performing the financial due diligence at the target’s subsidiary, the company identified a transaction involving a higher-than-normal commission to a sales agent in Asia. PwC was asked to perform an anti-corruption due diligence with a specific focus on transactions with or through sales agents.</td>
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<td>Responding immediately by deploying a team with deep anti-corruption skills, language capabilities, and experience in the A&amp;D industry, PwC:</td>
<td>• Performed data mining of commission payments and their associated sales to identify outliers, especially with respect to sales to state-owned entities</td>
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<td>• Conducted reputational due diligence to determine whether the sales agent had any governmental affiliations</td>
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<td>• Analyzed agreements, side letters, and payment records to determine the recipient of the funds, and determine who at the target approved the payments</td>
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<td>• Interviewed various target employees, including the sales director, sales representative, and finance manager</td>
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<td>Based on PwC’s findings, the company was able to negotiate a reduction in the purchase price by opting not to acquire the tainted segment of the target’s operations. The company also avoided potential successor liability by not acquiring the tainted segment.</td>
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PwC’s aerospace and defense experience

Deep aerospace and defense experience

PwC’s A&D practice is a global network of 1,200 partners and client service professionals who provide industry-focused assurance, tax, and advisory services to leading A&D companies around the world. This A&D experience is enhanced by our Public Services practice, which includes an additional 600 partners and 9,000 professionals focused on assisting federal, state, and local governments, international agencies, and healthcare entities. We help A&D companies address the full spectrum of industry-specific challenges across areas such as assurance, tax, operational improvement, supply chain management, program management effectiveness, IT effectiveness and security, compliance, export control, and government contracting. PwC’s A&D client service professionals are committed—both individually and as a team—to the relentless pursuit of excellence, building insights, and advancing leadership on a wide range of the most critical challenges and issues confronting A&D organizations. PwC is a sponsor of leading industry conferences and frequently writes articles for, or is quoted in, leading industry publications. We are proud of our relationships with Aviation Week and Flight International as well our participation in industry conferences and associations, such as the Aerospace Industries Association and American Conference Institute. Our involvement in these organizations reflects our commitment to addressing industry needs and the furthering of dialogue with A&D industry leaders.

Quality deal professionals

PwC’s Transaction Services practice, with approximately 6,500 dedicated deal professionals worldwide, has the right industry and functional experience to advise you on all factors that could affect a transaction, including market, financial accounting, tax, human resources, operating, information technology, and supply chain considerations. Teamed with our A&D practice, our deal professionals can bring a unique perspective to your transaction, addressing it from a technical as well as industry point of view.

Local coverage, global connection

In addition to the 1,200 professionals who serve the A&D industry, our team is part of an extensive Industrial Products group that consists of more than 32,000 professionals, including approximately 17,000 providing assurance services, 8,300 providing tax services, and 7,000 providing advisory services. This expands our global footprint and enables us to concentrate efforts in bringing clients a greater depth of talent, resources, and expertise in the most effective and timely way.

North America & the Caribbean
5,000 Industrial Products professionals
430 Aerospace & Defense industry professionals

South America
2,300 Industrial Products professionals
40 Aerospace & Defense industry professionals

Middle East & Africa
1,200 Industrial Products professionals
30 Aerospace & Defense industry professionals

Europe
14,200 Industrial Products professionals
610 Aerospace & Defense industry professionals

Asia
8,300 Industrial Products professionals
55 Aerospace & Defense industry professionals

Australia & Pacific Islands
1,300 Industrial Products professionals
35 Aerospace & Defense industry professionals
**Contacts**

**PwC’s global Aerospace and Defense practice**

PwC’s A&D practice provides industry-focused assurance, tax, and advisory services. Through our global network, we can draw upon the in-depth industry experience of professionals in every country where your company operates. Our people can help you deal with the challenges of today, and they understand the implications for tomorrow.

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Methodology

*Mission control* is an analysis of mergers and acquisitions in the global aerospace and defense industry. Information was sourced from Thomson Financial and includes deals for which targets or acquirers have primary SIC codes that fall into one of the following SIC industry groups: 1) ordnance and accessories, except vehicles and guided missiles; 2) aircraft and parts; 3) national security; 4) guided missiles, space vehicles, and parts; 5) search, detection, navigation, guidance, aeronautical and nautical systems, and instruments and equipment (SDNGN &NS, I&E); and 6) space research and technology.

This analysis includes all individual mergers and acquisitions for disclosed or undisclosed values, leveraged buyouts, privatizations, minority stake purchases, and acquisitions of remaining interest announced between July 1, 2008 and June 30, 2011, with a deal status of completed, intended, partially completed, pending, pending regulatory approval, unconditional (i.e., initial conditions set forth by the acquirer have been met but deal has not been completed), or withdrawn. The term *deals*, when referenced herein, is used interchangeably with *transactions* and *announcements*. Unless otherwise noted, the term *deals* refers to all deals with a disclosed value of at least $50 million.

Regional categories used in this report approximate United Nations (UN) Regional Groups as determined by the UN Statistics Division, with the exception of the North America region (includes North America and Latin and Caribbean UN groups), the Asia and Oceania region (includes Asia and Oceania UN groups), and Europe (divided into United Kingdom, plus Eurozone and Europe ex-UK and Eurozone regions). The Eurozone includes Austria, Belgium, Cyprus, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Malta, Netherlands, Portugal, Slovenia, and Spain. Oceania includes Australia, New Zealand, Melanesia, Micronesia, and Polynesia. Overseas territories were included in the region of the parent country. China, when referenced separately, includes Hong Kong.