

Aerospace & Defence - Q4 2021 Industry Update

Hopes of further unlocking of the commercial aerospace market in Q4 were rapidly squashed by the Omicron variant. This has not however put off those with conviction on the aerospace market paying multiples that look beyond the near term disruption and pricing-in robust growth in the long term. Whilst, by the end of the year, Global RPKs were forecast to still be at c. 60% of 2019 levels and the Wide Body fleet is not forecast to be back at 2019 levels till 2025 there is enough positive momentum in the commercial aerospace market to sustain interest and valuations. At a macro level the global middle class continues to grow and the global consumer, when given the opportunity, has proven their eagerness to travel and spend on experiences having spent 2020 and 2021 focussed on spending on goods. Whilst the industry continues to invest to deliver long term de-carbonisation solutions, in the near term the only credible option is to fly on newer, more efficient planes. That and the rising price of oil, now over \$80 a barrel, will underpin new build deliveries. The narrow body super-cycle remains alive and kicking; Airbus are forecasting an OE CAGR of 11% from 2022 to 2025 – all driven by growth in A320 and A220. Airbus delivered 611 planes last year, up 8% from 2020, and announced 507 net orders. Whilst Boeing has lagged behind, delivering 340 planes in 2021, net orders stand at 535 for the year and recertification of the MAX in China pre-Christmas should close the gap in 2022. Whilst intercontinental travel remains subdued due to the decline in business flying and geo-political tensions across Asia, Business jets are set to continue their impressive momentum. By October 2021 deliveries were 5% higher in large jets than the same period in 2019, 12% higher for medium jets and 8.5% higher for small jets. Once Omicron has passed, and whilst the industry awaits the next variant the key risk will be on execution. Labour markets in the US have historically been tighter than in Europe, but nevertheless A&D players in Europe, especially in the UK, have been reporting significant wage pressures.

In the aerospace supply chain we expect to continue to see continued consolidation, encouraged by OEMs, driven by well capitalised platforms (mostly sovereign and private equity backed) and facilitated by the weakened balance sheets of those remaining independent players. Whilst some consolidation will be obligated and pricing will reflect this we do expect to see increasing amounts of M&A activity that prices in long term growth with valuations starting to creep back to pre-Covid levels.

Aerospace

Company	Country	Market Cap (GBPm)	Net Debt / (GBPm) (Cash)	Adj EV (GBPm)	Net debt / EBITDA (2021)	EV/Revenue			EV/EBITDA			EV/EBIT			2 Year CAGR 2020-2022		
						Revenue (GBPm) Revenue growth			EBITDA (GBPm) EBITDA %			EBIT (GBPm) EBIT %			EBITDA Sales		
						2020	2021	2022	2020	2021	2022	2020	2021	2022	2020	2021	
Airbus SE	DE	74,161	(1,485)	71,177	n/a	1.6x	1.6x	1.4x	18.9x	11.8x	9.9x	49.2x	18.3x	14.4x	6%	38%	
						44,719	43,731	50,611	(25%)	(2%)	16%	3,762	6,028	7,201	1,447	3,886	4,942
Boeing Company	US	87,378	31,421	118,929	10.0x	2.8x	2.5x	1.9x	nmf	38.0x	17.1x	nmf	nmf	23.1x	23%	n/a	
						42,597	47,983	64,123	(26%)	13%	34%	(4,697)	3,132	6,975	(6,826)	1,504	5,139
Bombardier Inc.	CA	2,353	4,381	6,991	9.8x	1.5x	1.6x	1.4x	nmf	15.6x	10.8x	nmf	48.5x	21.5x	2%	n/a	
						4,751	4,491	4,917	(16%)	(5%)	9%	(7)	448	650	(218)	144	325
Dassault Aviation SA	FR	6,637	(2,884)	2,131	n/a	0.4x	0.4x	0.5x	5.3x	4.0x	4.1x	8.0x	5.5x	5.9x	(2%)	14%	
						4,926	5,630	4,725	(21%)	14%	(16%)	402	536	521	265	384	360
HEICO Corporation	US	13,491	149	13,850	0.4x	10.5x	9.8x	8.5x	40.4x	37.3x	31.5x	47.2x	45.8x	37.8x	11%	13%	
						1,315	1,415	1,626	(15%)	8%	15%	343	372	439	294	302	366
Meggitt PLC	UK	5,748	823	6,551	2.7x	3.9x	4.1x	3.6x	22.9x	21.7x	17.1x	52.1x	34.8x	24.7x	3%	16%	
						1,684	1,584	1,796	(26%)	(6%)	13%	287	302	384	126	188	265
MTU Aero Engines AG	DE	8,034	585	8,230	1.0x	2.3x	2.2x	1.9x	18.7x	13.9x	11.4x	30.4x	21.4x	16.2x	10%	28%	
						3,563	3,664	4,314	(9%)	3%	18%	441	591	723	270	385	507
Rolls-Royce Holdings plc	UK	10,239	5,141	14,991	3.7x	1.3x	1.3x	1.2x	nmf	10.7x	8.2x	nmf	24.1x	16.0x	3%	n/a	
						11,824	11,778	12,634	(29%)	(0%)	7%	(842)	1,395	1,838	(1,792)	623	937
Safran SA	FR	38,544	2,424	39,563	1.0x	2.6x	3.0x	2.6x	15.4x	16.3x	12.7x	30.7x	26.4x	18.5x	2%	10%	
						15,034	13,106	15,497	(29%)	(13%)	18%	2,567	2,432	3,119	1,290	1,499	2,144
Senior plc	UK	610	147	754	2.7x	1.0x	1.1x	1.0x	nmf	13.6x	9.8x	nmf	nmf	28.0x	0%	n/a	
						734	660	737	(34%)	(10%)	12%	(118)	55	77	(178)	6	27
Singapore Technologies Engineering Ltd	SING	6,413	782	7,080	1.4x	1.8x	1.7x	1.6x	13.4x	12.8x	12.2x	20.2x	20.5x	18.9x	6%	5%	
						3,967	4,163	4,485	(10%)	5%	8%	529	553	581	351	345	375
Textron Inc.	US	12,567	1,622	14,189	1.4x	1.5x	1.4x	1.3x	13.8x	12.0x	11.0x	17.7x	16.0x	14.3x	8%	12%	
						9,184	10,099	10,705	3%	10%	6%	1,028	1,181	1,289	801	890	991
Thales S.A.	FR	13,379	2,155	14,581	1.0x	1.0x	1.0x	1.0x	7.8x	6.8x	6.2x	16.9x	10.0x	8.7x	(0%)	12%	
						15,221	14,288	15,176	(2%)	(6%)	6%	1,878	2,136	2,365	862	1,460	1,682
Min						0.4x	0.4x	0.5x				5.3x	4.0x	4.1x	8.0x	5.5x	5.9x
Mean						1.8x	2.4x	2.1x				17.4x	16.5x	12.4x	30.3x	24.7x	19.1x
Median						1.6x	1.6x	1.4x				15.4x	13.6x	11.0x	30.4x	21.4x	18.5x
Max						3.9x	9.8x	8.5x				40.4x	38.0x	31.5x	52.1x	48.5x	37.8x

Source: CapIQ.

Note: Multiples are based on enterprise value as of 30 September 2021 and historical and forecast sales, EBITDA and EBIT, calendarised to 31 December. "nfm": not meaningful; "n/a": not available. Adjusted EV takes into consideration IFRS16.

The Defence market remains robust and is underpinned by continued geo-political tensions. The key near term beneficiaries being major orders for Rafale, F35 and nuclear submarines. Whilst only the US and UK are currently exceeding the 2% NATO guidance on defence spending France is edging closer and NATO equipment spend amongst top 6 countries (c. 90% of total spend), increased by \$10bn in 2021. France in particular in 2022 is allocating 58% of its 2022 defence budget to equipment spend, versus a 20% NATO target. In the US we expect Biden's 5year Defence preliminary budget in February, and the National Defence Strategy and Nuclear Posture in Spring 2022 to maintain long term confidence in the sector. Within the supply chain, access to security approved engineers in defence is becoming a challenge and constraint on development. Inflation across the supply chain has put pressure on margins in the commercial sector where there is little appetite from the airlines and lessors to absorb price increases; whilst the defence sector has more cost plus agreements, these erode the overall defence budget and there will be a lag before the margins are able to recover.

Defence

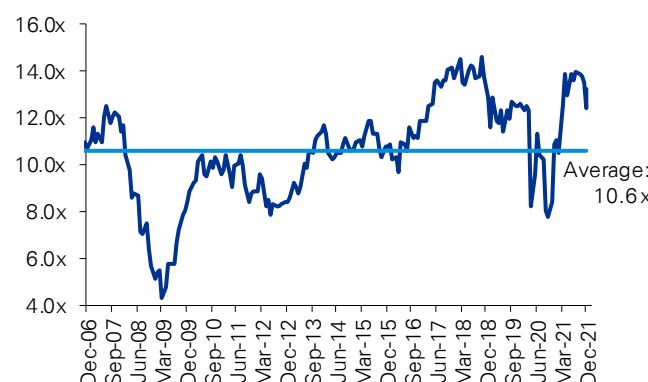
A	Country	Market Cap (GBPm)	Net Debt / Cash (GBPm)	Net debt EV / EBITDA (2021)	EV/Revenue			EV/EBITDA			EV/EBIT			2 Year CAGR 2020-2022	
					Revenue (GBPm) Revenue growth			EBITDA (GBPm) EBITDA %			EBIT (GBPm) EBIT %				
					2020	2021	2022	2020	2021	2022	2020	2021	2022		
BAE Systems plc	UK	17,381	3,828	20,940 1.4x	1.1x	1.0x	0.9x	9.1x	7.6x	7.1x	12.2x	9.5x	8.9x	7% 13%	
				19,277 5% 11% 4%	2,293	2,757	2,934	1,713	2,197	2,341					
Elbit Systems Ltd.	Israel	5,664	1,001	6,539 2.3x	1.9x	1.7x	1.6x	18.4x	15.3x	14.5x	24.4x	19.2x	17.9x	8% 13%	
				3,415 0% 13% 4%	355	428	450	268	340	365					
General Dynamics Corporation	USA	42,914	8,986	51,900 2.4x	1.9x	1.8x	1.7x	13.9x	13.9x	13.2x	15.6x	16.8x	15.8x	4% 3%	
				27,778 (6%) 3% 4%	3,728	3,725	3,921	3,320	3,088	3,295					
Kratos Defense & Security Solutions, Inc.	USA	1,776	11	1,798 0.2x	3.3x	3.0x	2.6x	43.1x	29.5x	24.5x	n.m.f.	n.m.f.	51.0x	11% 32%	
				552 1% 8% 14%	42	61	73	25	21	35					
L3Harris Technologies, Inc.	USA	30,902	4,969	35,952 1.7x	2.7x	2.7x	2.6x	13.0x	12.2x	11.9x	13.4x	14.2x	13.5x	3% 5%	
				13,118 (5%) 2% 3%	2,776	2,959	3,034	2,675	2,539	2,666					
Leidos Holdings, Inc.	USA	9,214	3,837	13,088 3.4x	1.3x	1.2x	1.2x	11.8x	11.5x	10.9x	14.1x	14.5x	13.1x	6% 4%	
				10,071 8% 6% 5%	1,114	1,134	1,198	928	900	999					
Leonardo S.p.a.	Italy	3,043	4,097	7,149 3.1x	0.6x	0.6x	0.6x	4.9x	5.4x	4.9x	6.6x	7.8x	6.9x	2% (0%)	
				12,015 3% (1%) 5%	1,464	1,317	1,453	1,088	918	1,031					
Lockheed Martin Corporation	USA	72,388	6,545	78,933 0.9x	1.6x	1.6x	1.6x	10.8x	10.3x	10.4x	11.3x	11.8x	12.1x	1% 2%	
				47,900 6% 3% (1%)	7,325	7,662	7,576	6,998	6,714	6,546					
Northrop Grumman Corporation	USA	45,319	7,174	52,493 1.6x	1.9x	2.0x	1.9x	13.0x	11.6x	13.8x	15.7x	12.2x	18.8x	1% (3%)	
				26,953 6% (1%) 3%	4,025	4,530	3,817	3,334	4,305	2,790					
Raytheon Technologies Corporation	USA	95,283	18,748	115,261 2.4x	2.8x	2.4x	2.2x	23.7x	15.0x	12.7x	58.8x	21.6x	18.3x	12% 37%	
				41,447 21% 15% 9%	4,864	7,690	9,066	1,959	5,332	6,292					
Rheinmetall AG	Germany	3,014	202	3,199 0.3x	0.6x	0.7x	0.6x	5.5x	4.6x	4.3x	9.2x	6.8x	6.2x	(1%) 13%	
				5,329 (0%) 9%	586	695	742	347	468	512					
Saab AB (publ)	Sweden	2,477	(72)	2,392 n/a	0.8x	0.8x	0.7x	11.9x	6.2x	5.7x	27.6x	10.1x	8.9x	3% 45%	
				3,160 11% 1% 6%	201	386	423	87	237	270					
Ultra Electronics Holdings plc	UK	2,267	65	2,332 0.4x	2.7x	2.7x	2.5x	16.6x	15.1x	14.1x	21.4x	18.2x	17.1x	3% 9%	
				860 4% 2% 5%	140	155	166	109	128	136					
Min				0.6x	4.9x	4.6x	4.3x	6.6x	6.8x	6.2x	(1%)	(3%)			
Mean				1.8x	15.0x	12.2x	11.4x	19.2x	13.6x	16.0x	5%	13%			
Median				1.9x	13.0x	11.6x	11.9x	14.9x	13.2x	13.5x	3%	9%			
Max				3.3x	3.0x	2.6x	43.1x	29.5x	24.5x	58.8x	21.6x	51.0x	12% 45%		

Source: Capital IQ.

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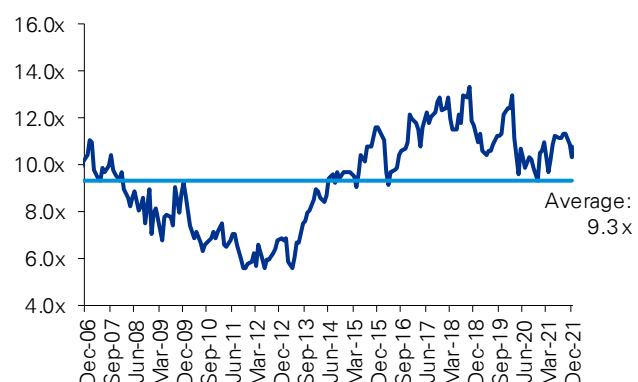
Sector valuation through the cycle (EV/LTM EBITDA)

Aerospace



Source: Capital IQ

Defence



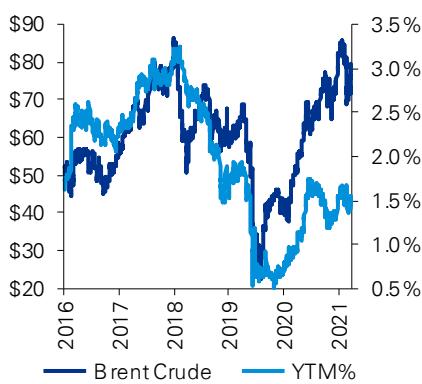
Source: Capital IQ

Selected recent M&A activity headlines

- Oct 2021 – **Mercury Systems** acquired **Avalex Technologies**, the US-based provider of rugged displays, integrated communications management systems, digital video recorders, and warning systems.
- Oct 2021 – **Vance Street Capital Partners** acquired **McFarlane Aviation, Inc**, a US-based designer and manufacturer of aftermarket PMA parts for the general aviation industry.
- Oct 2021 – **CAE Inc.** agreed to acquire the **AirCentre Airline Operations Portfolio** of **Sabre Corporation**
- Nov 2021 – **The Carlyle Group** and **Stellex Capital Management** acquired **IMIA Group Holdings**, a US-based provider of comprehensive marine preservation, structural, scaffolding & environmental containment, and staffing services for the MRO and construction of the U.S. Navy fleet, from **J.F. Lehman & Company**
- Nov 2021 – **Rheinmetall** acquired **Elektro-Mechanische Technologien** (EMT), the Germany-based unmanned air vehicle maker designed to carry various payloads for short and medium ranges of up to 100 km
- Nov 21: **BAE Systems** entered into a definitive agreement to acquire **Bohemia Interactive Simulations**, the Czech-based software developer of simulation training solutions for military organisations from **The Riverside Company**
- Dec 2021 – **Latécoère S.A.** entered into definitive agreement to acquire **Malaga Aerospace Defence and Electronic Systems**, (previously Raytheon Microelectronics) from **American Industrial Acquisition Corporation**
- Dec 2021 – **Vertex Aerospace, LLC** agreed to acquire **Defense Training and Mission Critical Solutions** from **Raytheon Technologies**
- Dec 2021 – **Thales Group** entered into a definitive agreement to acquire the **Navigation Aids Business** of **Moog Inc.**

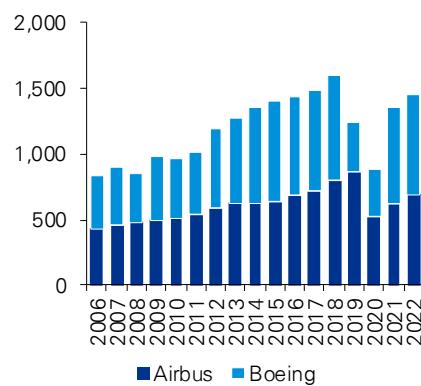
Economic indicators

Brent Crude (\$) vs. US 10 Yr Treasuries



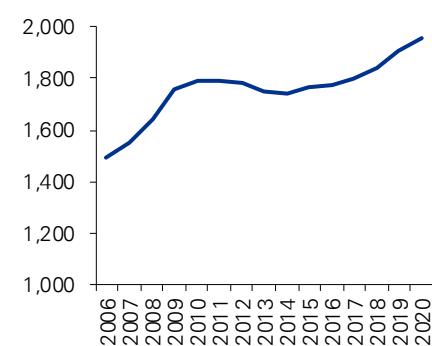
Source: Capital IQ

Delivered Commercial Aircraft (Units)



Source: Airbus and Boeing annual report, UBS, JPMorgan, Barclays.

Global Defence Spend (\$bn)



Source: SIPRI Military Expenditure Database

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The information in this document is based on data obtained from Bloomberg, CapitalIQ, EIU, Mergermarket, WTO and is based on KPMG analysis.

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