

# Aerospace & Defence - Q2 2022 Industry Update

Labour driven disruptions have been the order of the day across commercial aerospace in both Europe and the US. In tight labour markets airlines and airports have been unable to entice back the staff let go over Covid in the face of a robust rebound in demand. Air Traffic Control at Gatwick has faced similar labour driven constraints – reducing airport capacity by 10% - whilst central and eastern Europe air space is severely congested due to detours around Russian and Belarusian airspace.

The return of Trans-Atlantic demand has not yet heralded the return of the wide body market. Despite Boeing expressing optimism that 787s will take to the air again soon, the return of the trans-Atlantic market has benefited the long range A320s at the expense of the wide body fleet. The 4200 A320s on order represent, to some extent, a cannibalisation of the wide body demand. The lower cost, lower emissions, direct flight option on offer from the A321XLR is increasingly attractive. Until the Asian market returns, and China shows little sign of opening up, the wide body return remains in doubt. International flights into China since the start of the year are 88% below 2019 levels, whilst Chinese airline capacity is still 30% below 2019 levels.

China remains problematic as an end market for Boeing. A recent contract award of over 290 aircraft to Chinese airlines see Airbus further consolidate its position with 4 out of the 9 major Chinese operators.

From an M&A perspective we are seeing buyers in the mid-market prepared to take a view on proforma financials that reflect the future recovery in build rates where they feel there is sufficient contractual cover and switching cost. Buyers are starting to give credit for future build rates (in narrow body), even though these build rates are at risk from the supply chain issues we describe above. Less certain is the financing of aerospace transactions. Lenders seem reluctant to bank on future recovery, or worried about existing exposure, and are at the conservative end of the leverage spectrum.

## Aerospace

Company	Country	Market Cap (GBPm)	Net debt / (Cash) (GBPm)	Adj EV (GBPm)	Net debt / EBITDA (2022)	EV/Revenue			EV/EBITDA			EV/EBIT			2 Year CAGR 2021-2023	
						Revenue (GBPm)			EBITDA (GBPm)			EBIT (GBPm)			EBIT %	
						2021	2022	2023	2021	2022	2023	2021	2022	2023	18%	26%
Airbus SE		62,621	(1,897)	59,315	n/a	1.4x (2%)	1.1x 18%	1.0x 18%	10.6x 13%	8.4x 14%	6.6x 15%	15.9x 9%	12.1x 9%	8.9x 11%		
Boeing Company		66,567	34,582	101,249	8.1x	2.2x 8%	1.6x 34%	1.3x 21%	nmf 2%	23.7x 7%	12.6x 11%	nmf (1%)	39.8x 4%	16.2x 8%	28% 8%	173%
Bombardier Inc.		1,198	4,253	5,716	5.9x	1.3x (5%)	1.1x 21%	0.9x 11%	21.3x 6%	7.9x 13%	6.0x 16%	39.7x 3%	16.6x 6%	10.9x 9%	16% 88%	
Dassault Aviation SA		10,655	(3,991)	5,099	n/a	0.8x 24%	1.0x (15%)	1.0x 2%	8.8x 9%	9.5x 10%	8.1x 12%	11.3x 7%	13.5x 7%	12.0x 8%	(7%) 4%	
HEICO Corporation		12,945	118	13,336	0.2x	9.5x 1%	7.3x 30%	6.6x 11%	36.3x 26%	27.3x 27%	24.1x 27%	42.2x 23%	32.7x 22%	28.6x 23%	20% 23%	
Meggitt PLC		6,161	778	7,018	2.2x	4.7x (12%)	4.1x 14%	3.6x 16%	29.6x 16%	19.6x 21%	16.7x 21%	nmf 16%	27.8x 21%	22.7x 15%	15% 33%	
MTU Aero Engines AG		7,985	513	8,498	0.7x	2.4x (1%)	1.9x 30%	1.7x 13%	18.2x 13%	11.3x 16%	9.7x 17%	28.2x 9%	16.7x 11%	13.6x 12%	21% 37%	
Rolls-Royce Holdings plc		6,941	5,254	11,817	4.0x	1.1x 11,218	1.0x 4%	0.9x 8%	9.3x 11%	9.1x 11%	7.2x 13%	25.4x 11%	23.5x 13%	14.8x 17%	6% 6%	
Safran SA		34,590	1,597	35,490	0.5x	2.8x (15%)	2.3x 22%	2.0x 15%	16.1x 17%	11.9x 19%	9.8x 20%	33.8x 8%	17.4x 13%	13.5x 14%	19% 28%	
Senior plc		477	153	626	2.2x	1.0x (10%)	0.8x 13%	0.8x 12%	11.1x 9%	8.9x 9%	7.0x 11%	nmf 2%	25.3x 3%	13.4x 6%	12% 26%	
Singapore Technologies Engineering Ltd		7,521	716	8,340	1.0x	2.0x 6%	1.6x 26%	1.4x 8%	14.9x 13%	11.9x 13%	10.3x 14%	23.2x 9%	18.9x 8%	16.1x 9%	17% 21%	
Textron Inc.		10,809	1,564	12,373	1.1x	1.2x 10%	1.0x 19%	1.0x 5%	10.6x 12%	8.6x 12%	8.1x 12%	13.7x 9%	11.3x 9%	10.4x 10%	12% 15%	
Thales S.A.		21,447	739	23,319	0.3x	1.7x (1%)	1.6x 9%	1.5x 7%	12.2x 14%	10.0x 16%	9.0x 16%	22.4x 8%	14.2x 8%	12.5x 11%	8% 16%	
Min						0.8x	0.8x	0.8x	8.8x	7.9x	6.0x	11.3x	11.3x	8.9x	(7%) 4%	
Mean						2.5x	2.0x	1.8x	16.6x	12.9x	10.4x	25.6x	20.7x	14.9x	14% 28%	
Median						1.7x	1.6x	1.3x	13.6x	10.0x	9.0x	24.3x	17.4x	13.5x	16% 24%	
Max						9.5x	7.3x	6.6x	36.3x	27.3x	24.1x	42.2x	39.8x	28.6x	28% 88%	

Source: CapIQ.

Note: Multiples are based on enterprise value as of 30 June 2022 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 Ukrainian conflict has materially strengthened the NATO alliance – with the additions of Finland and Sweden – whilst simultaneously exposing a number of weaknesses in European defence capabilities. On the one hand specialist capabilities have been neglected or paid lip service to; credible Chemical, Biological, Radiological and Nuclear defence capabilities are lacking outside the major powers. On the other the industrial supply chain for artillery munitions and guided missiles has been woefully under invested. It lacks the capacity, and increasingly, the manpower, to respond quickly. It will take at least two years to return stockpiles to normal levels ignoring any sustained requirement to re-supply Ukraine or to meet increased NATO training requirements. That pledges of support have, largely, been slow to materialise, reflects, in the most part, this under investment in the supply chain and a paucity of deployable reserves rather than a reduction in political commitment. The US continues to recognise the Ukraine as a strategic priority – any compromise now would signal weakness to China – and the European nations are aligned, with a couple of notable exceptions, behind this aim. Such commitment was reflected by the agreement at the Madrid NATO summit to increase the number of NATO troops on high readiness from 40,000 to 300,000 from 2023. Whilst Europe remains a fragmented market in which national considerations dominate both procurement and M&A activities there does remain opportunity for British businesses. The lacklustre availability record of the German fast jet fleet would potentially benefit from the type of availability based service model developed in the UK - which is ironic as the Chief of the General Staff in the UK recently called for the end of the whole fleet management model for armoured vehicles. Against a backdrop of political chaos a concerted effort by the Defence Secretary, supported by his heads of service, to increase defence spending seems to have had the desired effect. Although whether future incumbents of number 10, faced by future fiscal constraints, honour the pledge of the outgoing Prime Minister to increase defence spending to 2.5% of GDP by 2030. In terms of M&A we have not yet seen an uptick in activity to reflect the positive market outlook. We suspect that this, in part, reflects the lack of accessible, available assets and in part, the long lead times and ongoing supply chain issues that are hindering the conversion of the order book to the bottom line. We do expect the significant increase in NATO high readiness forces and the added emphasis on inter-operability to mean that the key beneficiaries in terms of spending and subsequent M&A will be communications, training and platform support related.

## Defence

					EV/Revenue Revenue (GBPm) Revenue growth			EV/EBITDA EBITDA (GBPm) EBITDA %			EV/EBIT EBIT (GBPm) EBIT %			2 Year CAGR 2021-2023		
Company	Country	Market Cap (GBPm)	Net Debt (Cash) (GBPm)	Adj EV / EBITDA (2022)	2021	2022	2023	2021	2022	2023	2021	2022	2023	Sales	EBITDA	
BAE Systems plc	UK	26,161	3,594	31,625	1.2x	1.6x	1.4x	14.2x	10.4x	9.9x	17.2x	13.1x	12.3x	9%	20%	
					19,521	22,280	23,242	2,224	3,034	3,208	1,844	2,417	2,577			
Elbit Systems Ltd.	Israel	8,308	909	9,088	1.8x	2.3x	2.0x	1.8x	22.6x	18.0x	16.4x	30.7x	22.7x	20.8x	12%	17%
					3,898	4,655	4,930	403	504	555	296	401	437	8%	9%	
General Dynamics Corporation	USA	50,467	7,832	58,299	1.8x	2.1x	1.8x	1.7x	15.0x	13.7x	12.4x	17.7x	16.6x	14.7x	11%	10%
					28,410	32,501	34,913	3,893	4,255	4,719	3,303	3,513	3,978			
Kratos Defense & Security Solutions, Inc.	USA	1,428	97	1,537	1.4x	2.5x	2.1x	1.9x	36.9x	21.5x	17.6x	nmf	nmf	35.9x	16%	45%
					606	738	819	42	72	87	23	23	43			
L3Harris Technologies, Inc.	USA	38,364	5,672	44,117	1.8x	3.4x	3.1x	2.9x	16.4x	14.3x	13.5x	21.9x	16.0x	15.3x	7%	10%
					13,156	14,437	15,111	2,686	3,087	3,256	2,013	2,763	2,882			
Leidos Holdings, Inc.	USA	11,326	4,137	15,504	3.4x	1.5x	1.3x	1.3x	14.1x	12.8x	12.0x	17.7x	16.6x	15.0x	10%	8%
					10,145	11,677	12,263	1,099	1,213	1,288	877	935	1,032	9%	8%	
Leonardo S.p.a.	Italy	4,790	4,087	8,900	2.8x	0.7x	0.7x	0.7x	7.9x	6.0x	5.5x	10.3x	8.6x	7.7x	6%	20%
					11,872	12,834	13,374	1,133	1,484	1,628	867	1,032	1,156			
Lockheed Martin Corporation	USA	94,309	7,402	101,711	0.9x	2.1x	1.9x	1.8x	15.3x	12.5x	12.1x	17.3x	14.6x	14.0x	6%	13%
					49,513	54,318	55,886	6,654	8,125	8,432	5,896	6,973	7,248			
Northrop Grumman Corporation	USA	61,220	9,064	70,284	2.3x	2.7x	2.3x	2.2x	10.9x	17.7x	16.7x	12.4x	23.6x	21.8x	9%	(19%)
					26,341	30,080	31,367	6,450	3,978	4,199	5,650	2,981	3,220			
Raytheon Technologies Corporation	USA	117,301	20,585	139,073	2.0x	2.9x	2.5x	2.3x	16.6x	13.5x	11.9x	27.1x	20.2x	17.1x	13%	18%
					47,552	56,230	61,065	8,400	10,302	11,697	5,139	6,893	8,117			
Rheinmetall AG	Germany	8,207	345	8,416	0.4x	1.8x	1.5x	1.2x	12.1x	9.6x	7.9x	16.0x	13.1x	10.5x	20%	24%
					4,752	5,720	6,787	694	881	1,059	526	643	801			
Saab AB (publ)	Sweden	4,479	(156)	4,316	n/a	1.3x	1.3x	1.2x	13.9x	10.2x	9.0x	18.5x	16.3x	13.9x	6%	24%
					3,198	3,337	3,615	310	424	478	233	265	310			
Ultra Electronics Holdings plc	UK	2,484	40	2,549	0.2x	3.0x	2.8x	2.7x	19.0x	15.3x	14.4x	22.5x	18.5x	17.5x	6%	15%
					851	913	953	134	167	177	114	138	145			
Min					0.7x	0.7x	0.7x	7.9x	6.0x	5.5x	10.3x	8.6x	7.7x	6%	(19%)	
Mean					2.1x	1.9x	1.8x	16.5x	13.5x	12.3x	19.1x	16.6x	16.7x	10%	16%	
Median					2.1x	1.9x	1.8x	15.0x	13.5x	12.1x	17.7x	16.4x	15.0x	9%	17%	
Max					3.4x	3.1x	2.9x	36.9x	21.5x	17.6x	30.7x	23.6x	35.9x	20%	45%	

Source: CapIQ.

Note: Multiples are based on enterprise value as of 30 June 2022 and historical and forecast sales. EBITDA and EBIT, calendarised to 31 December. "nmf": not meaningful; "n/a": not available. Adjusted EV takes into consideration IFRS16.

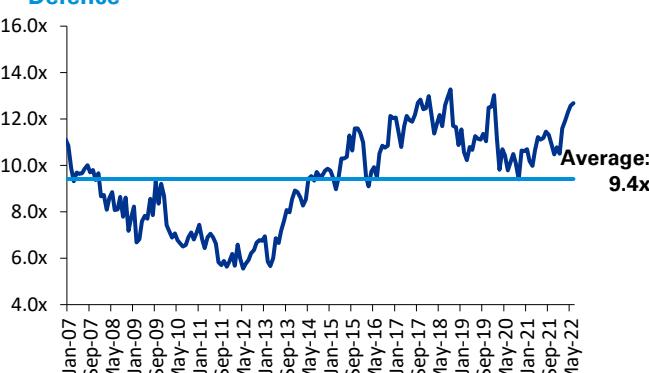
## Sector valuation through the cycle (EV/LTM EBITDA)

### Aerospace



Source: Capital IQ

### Defence



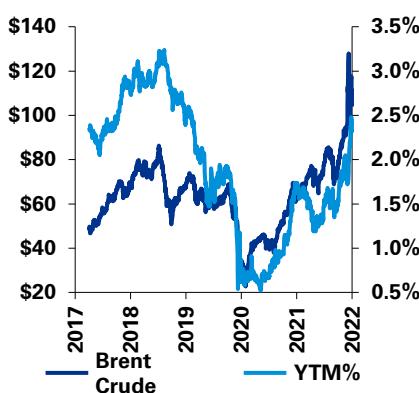
Source: Capital IQ

## Selected recent M&amp;A activity headlines

- Jun 2022 - **Leonardo SpA**, has acquired **Rada Electronic Industries Ltd**, the listed Israel based manufacturer of electronic equipment for the aerospace and commercial aviation markets
- **Jun 2022 – Doncasters Group acquired Uni Pol, a China-based provider of investment castings for the aerospace and automotive industries**
- **May 2022 – Textron Aviation acquired Mistequay Group, the US based precision manufacturer of aviation components**
- **May 2022 – Latécoère S.A. agreed to acquire Avcorp Industries Inc., the listed Canada-based provider of integrated composite and metallic aircraft structures to aircraft manufacturer**
- May 2022 – **B-Technology & Innovation Industrial Group (BT2i)**, the France based specialist in the design and production of metal parts and sub-assemblies for aerospace manufacturers and equipment suppliers has been acquired by **Tikehau Ace Capital**
- Apr 2022 - **Thales** has acquired **Advanced Acoustic Concepts Inc**, the US based provider of sonar systems, acoustic training systems, and software integration for navy and homeland security applications from **Leonard DRS**
- **Apr 2022 – Accurus Aerospace, a portfolio company of Liberty Hall Capital Partners, has acquired Ferra Holdings Ltd, the Australia based provider of advanced components, sub-systems and assemblies for military and commercial aerospace**
- **Apr 2022 – Communication and Power Industries (CPI)**, the US-based maker of components and subsystems for radar and electronic warfare, has been acquired by **the Jordan Company**
- Apr 2022 - **GS Precision Inc**, has acquired **FT Gearing Systems Ltd**, the UK based manufacturer of highly engineered gears to the aerospace and defence industries
- Apr 2022 - **American Industrial Acquisition Corp** has acquired **MB Aerospace Sterling Heights Inc**, the US based provider of machining of high-value cast components for aerospace and industrial markets from **MB Aerospace**, a portfolio company of **Blackstone**

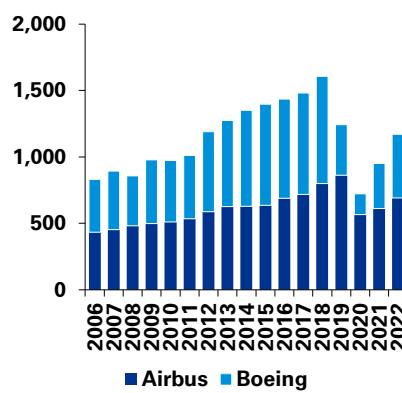
## Economic indicators

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



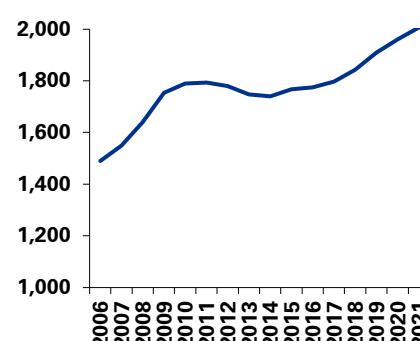
Source: Capital IQ

## 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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