

The New Normal: Mergers and Acquisitions

Written by Nick Sanders

Thursday, 20 February 2020 00:00 -

It was dubbed “the Last Supper.”

In 1993, then Secretary of Defense Les Aspin and his Deputy William Perry hosted the CEOs of the top defense firms and issued the ultimatum that shrinking defense budgets would require consolidation among them. That mean set off “feeding frenzy” (according to one source) in which companies competed to acquire each other, knowing that only a few companies would be left to survive the looming defense budget cuts of the Clinton administration. Within seven years “107 firms had become five,” according to another source.

That was 25+ years ago, but the recent wave of mergers and acquisitions seems very reminiscent of those times.

-

In 2015, Lockheed Martin acquired Sikorsky Aircraft from United Technologies Corporation (UTC) for \$9 billion.

-

In 2015, Harris Corporation merged with Exelis, Inc., in a \$4.75 billion deal. Exelis itself had been a 2011 spin-off from ITT Corporation. In 2017, the combined company spun-off its government IT business, which is now called Peraton.

-

In 2017, UTC acquired Rockwell Collins in a \$30 billion deal, which created Collins Aerospace.

-

In 2018, Northrop Grumman acquired Orbital ATK for \$9.2 billion. (Orbital ATK was the successor company from a 2015 merger between Orbital Sciences and Alliant Techsystems.)

-

The New Normal: Mergers and Acquisitions

Written by Nick Sanders

Thursday, 20 February 2020 00:00 -

In 2018, Harris and L3 Corporation merged to create L3 Harris Technologies. Just before the merger, L3 had sold its Vertex Aerospace business to a private equity firm for \$540 million. The combined L3 Harris corporation "... will have approximately 48,000 employees and customers in over 100 countries, with an expected net revenue of \$16 billion in calendar year 2018," according to the accompanying press release.

-

In 2018, General Dynamics acquired CSRA, an IT services company, in a deal valued at \$9.7 billion. CSRA was already the 39th largest defense contractor, prior to the acquisition.

-

In 2019, UTC and Raytheon Corporation announced that they would merge, creating Raytheon Technologies Corporation sometime in 2020 (depending on when regulatory approvals are received). At the time the merger was announced, the combined entity was projecting \$74 billion in annual sales, making it second only to The Boeing Company and well ahead of Lockheed Martin's annual sales of \$60 billion. (The merger of Lockheed and Martin Marietta took place in 1994, just after the "last supper.")

Also in 2019, Leidos agreed to acquire Dynetics for \$1.7 billion; Parker Hannifin acquired Exotic Metals for \$1.7 billion; and Pacific Architect and Engineers was acquired by a private equity firm for \$1.6 billion. And Fluor Engineering announced its intention to divest itself of its Federal Servicers business.

And the activity continues in 2020. In January, Woodward and Hexcel announced "an all-stock merger of equals." The combined entity, Woodward Hexcel, is expected to generate roughly \$5 billion in sales. Not to be outdone, in January BAE Systems agreed to acquire Collin Aerospace's GPS business for \$1.9 billion and Raytheon's Airborne Tactical Radio business for \$275 million. The GPS business sale is notable because the business is headquartered in Cedar Rapids, Iowa. That was the location of the headquarters of the entity formerly known as Rockwell Collins.

With all that activity, you'd think people would be pretty good at integration, wouldn't you? Our experience tells us you'd be wrong about that.

The New Normal: Mergers and Acquisitions

Written by Nick Sanders

Thursday, 20 February 2020 00:00 -

Everybody is anxious when an acquisition, merger, or divestiture happens. People wonder if they'll get laid off. People wonder if the sacrifices they've made for their careers will be rewarded, or if they'll have to start again. Politics is king. And thus, in too many instances the business synergies are not achieved. If studies are to be believed, the majority of such activities don't reach their objectives. In other words, they fail.

A case in point: the recent problems at The Boeing Company have been attributed to the culture of McDonnell Douglas. Boeing and McDonnell Douglas (MDC) merged in 1997. According to [this story](#)

:

In a clash of corporate cultures, where Boeing's engineers and McDonnell Douglas's bean-counters went head-to-head, the smaller company won out. The result was a move away from expensive, ground-breaking engineering and toward what some called a more cut-throat culture, devoted to keeping costs down and favoring upgrading older models at the expense of wholesale innovation. Only now, with the 737 indefinitely grounded, are we beginning to see the scale of its effects.

'The fatal fault line was the McDonnell Douglas takeover,' says Clive Irving, author of *Jumbo: The Making of the Boeing 747*. 'Although Boeing was supposed to take over McDonnell Douglas, it ended up the other way around.'

In case you want more than one data point, here's [another story](#) with the same theme. That second article asserts:

It was this MDC-dominated leadership and Board that sent Boeing into a downward spiral. MDC starved Douglas Aircraft for R&D money and relied on derivatives. During the period 1998-2003, Boeing's R&D fell precipitously ... Boeing offered derivatives of in the form of the 737-900 (not today's more successful ER), 757-300 and 767-400, all sales duds. Boeing talked and talked and talked about new airplanes but had no action.

Thus, the lesson to be learned is that politics and self-dealing can create a culture that leads to

The New Normal: Mergers and Acquisitions

Written by Nick Sanders

Thursday, 20 February 2020 00:00 -

sub-optimal outcomes. Just ask any Boeing investor.

From a compliance point of view, there are myriad details to be sorted out. Among those details are: pools, bases and indirect rates; cost accounting practices and disclosure statements; policies, procedures and practices. Restructuring cost savings proposals. Novation agreements. Determining home office functions/activities versus shared service functions/activities versus what takes place at the segment/business unit.

And business systems.

Each of the six DFARS business systems will need to be sorted out. Of all the aspects of a merger/acquisition of two large defense contractors, this may be the most important and least appreciated issue to be sorted out. Each of those six business systems has policies, procedures, and practices that determine how the entity complies with the DFARS business system adequacy criteria. Each of those six business systems is subject to audit/review by government oversight officials. Each of those six business systems can be determined to be inadequate—which leads inexorably to payment withholds. Payment withholds do not look good on the new entity's cash flow reports.

You'd like to think that each of these large aerospace/defense companies would have a repeatable strategy, a secret formula if you will, for executing these large-scale mergers, acquisitions, and divestitures. You'd like to hope that each of these entities has a team of the best and brightest dedicated to sorting-out all the details and issues that come up, and that would assure the planned business objectives were being met.

And maybe they do!

But we wouldn't bet on it.