MARKET OUTLOOK

Industry Trends and Supply Chain Challenges Continue to Drive Aerospace Companies to Seek Capital Market and M&A Solutions

By Brian Murphy, *Meridian Capital*

Global aerospace suppliers continue to face the challenges and opportunities associated with a rapidly evolving industry under consolidation. Recent industry dynamics have led many shareholders and management teams to pursue capital market or M&A alternatives to strengthen their companies' position for continued competitiveness and future growth.

CURRENT SUPPLIER CHALLENGES

- 737MAX Production Halt
- Raw Material Shortages and Expanded Lead Times
- Tight Labor Market
- Ongoing Pricing Pressure from OEM and Key Tier 1 Suppliers

SOLUTIONS OFFERED VIA M&A AND CAPITAL MARKETS

- Liquidity to Mitigate Execution Risk
- Accelerated Investment in Automation, Capacity, or Enhanced Capabilities
- Vertical Integration
- Access to New Customers or Platforms

Over the past 12 months alone industry participants have been confronted with:

737MAX Production Halt

The production freeze and uncertainty of build-rate recovery driven by the grounding of 737Max will likely cause significant financial and operational challenges for companies within the commercial supply chain—particularly closely held entities relying on more lean balance sheets. In December, Boeing announced plans to temporarily suspend production of the 737MAX beginning in January with no definitive timeline for a re-ramp in the build rate. The impact to supply chain order volumes has yet to be outlined. Boeing may continue to order components at reduce rates and offer ship-in-place or other inventory management programs. That said, Spirit AeroSystems has already indicated its intention to suspend 737MAX related production in January. Aside from the financial impact, in the event Boeing reduces or halts ordering from suppliers, the supply chain may face challenges retaining labor making it difficult to quickly ramp to future build rate demands.

Raw Material Shortages and Expanded Lead Times

Significant raw materials shortages at TMX as well as tight capacity within the finish processing community has led to delays, extended lead times, and increased expedite charges. In order to maintain on-time performance, suppliers have counteracted by increasing their investment in working capital and inventory.

Tight Labor Market

Limited availability and competition for experienced manufacturing talent has required suppliers to pursue creative recruitment strategies, establish more robust in-house training capabilities, and increase investment in automation.

Ongoing Pricing Pressure from OEM and Key Tier I Suppliers

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Despite these challenges, the long-term macroeconomic drivers and forecasted trends for the industry remain attractive. This has equated to continued transaction interest from both industry and financial investors. As a result, transaction activity has remained active as suppliers and business owners look to enhance their competitive position. Through Q3 of 2019, over 300 aerospace and defense transactions have been completed globally, representing an 11% increase over the same period last year. Washington State has been home to several recent, high profile transactions including Parker Hannifin's acquisition of Exotic Metals Forming, Sekisui Chemical's acquisition of AIM Aerospace, and Transdigm's acquisition of Esterline Technologies.

The combination of challenging near-term industry dynamics and strong investor interest is driving many tier-I and tier-II aerospace suppliers to look to capital markets for solutions. Shareholders and management teams often view access to incremental capital and/or M&A partnerships as an opportunity to de-risk key initiatives or address competitive shortcomings.

We are seeing shareholders pursue transactions to achieve the following strategies:

Liquidity to Mitigate Execution Risk

Given the investments required to remain competitive and grow with OEM customers, several privately-owned suppliers are finding that their personal risk appetite is unaligned with the optimal risk profile required for their business. Financial partners can provide partial liquidity or business growth financing to help align risk tolerance.

Accelerated Investment in Automation or Enhanced Capabilities

Continuous investment in automation, new equipment, and advanced capabilities are critical to remaining cost competitive, meeting future build rate requirements and building capacity for growth. Financial or industry partners can support or accelerate the timing of these investments. Investments in automation are occurring throughout the aerospace supply chain with large industry players looking to acquire companies that can provide automation or additional capabilities. Airbus recently announced in December of 2019, that it has acquired Washington-based MTM Robotics, an industrial automation company. The acquisition provides MTM with meaningful resources to continue to invest in R&D and augment its capabilities for continued growth.

Vertical Integration

Suppliers are looking to acquisition to add finish processing, tooling, or more differentiated manufacturing capabilities to capture margin and better control supply chain inefficiencies or lead time increases. In July of 2019, ARCH Global Precision backed by the Jordan Company completed its acquisition of Siem Tool. In addition to expanding the Company's cutting tool product offering, the acquisition provides ARCH with an in-house coating center that can be leveraged across ARCH's portfolio of companies.

Access to New Customers or Platforms

Acquirers and sellers alike are pursuing M&A in an effort to provide the scale and customer diversification needed to stabilize financial performance and increase negotiating flexibility with OEMs. Through its portfolio company, Bromford Industries, Liberty Hall Capital Partners acquired Numet Machining Techniques, Inc., a supplier of complex engine components in November 2019. The acquisition of Numet provides the U.K.-based Bromford access to incremental aerospace engine platforms and access to leading U.S. customers.

The bottom line? It is becoming increasingly difficult for small and mid-sized aerospace suppliers to remain competitive and meet OEM demands. Significant investment is often required to move up the value chain, meet capacity needs, and remain competitive on price. As a result, expect privately-owned aerospace suppliers to leverage attractive transaction and capital market solutions throughout 2020.