

Aerospace And Defense Industry Confronts Wave Of New Owners

Michael Bruno September 21, 2022



GKN Aerospace's new wiring facility in Pune, India (pictured), and another plant in Langfang, China, were behind a multiyear deal with Boeing for electrical interconnection systems for the 777X.

Credit: GKN

When GKN Aerospace announced in February that it planned to shut down its storied St. Louis defense manufacturing center, the proverbial shockwave reached both U.S. coasts, where industry veterans—some of whom had worked in the decades-old plant—expressed sadness over its demise.

Local news reports lamented the loss of a community point of pride, whose roots stemmed from the former McDonnell Douglas and which made major parts for the F-15, F-18, Sikorsky CH-53 and other military aircraft. Some remembered when GKN bought the plant from McDonnell successor Boeing in 2000 with big plans to build up its U.S. defense work.

- Aerospace and defense industry confronts a wave of new owners
- Private equity firms are the most prevalent type of buyer
- Applying new business practices to old assets will trigger lots of change

Now, members of Congress in Washington want answers from the Tier 1 supplier's new CEO, David Paja, noting that GKN is one of the largest manufacturing employers in the Midwest. The International Association of Machinists and Aerospace Workers is seeking government help for the roughly 900 workers who will lose their jobs there.

But for GKN's private equity owner Melrose Industries, it is business as usual. The closure, to be completed next year, follows a well-tread private equity strategy as the company buys, improves and ultimately sells the Tier 1 aerostructures provider and the rest of GKN's automotive and metallurgy businesses in coming years.

Under the strategy, Melrose plans to cut GKN Aero's global site presence to 33 plants by 2023 from 51 in 2019. Eight closures are being considered in the U.S. and Europe by 2025. By then, the private equity owner can sell GKN businesses under an agreement with UK officials reached during the 2018 takeover. Melrose expects to achieve annual operating margins of at least 14%, assuming a recovery to pre-pandemic commercial aviation levels. That is up from 10.6% before the private equity firm bought it, though executives say margins will increase 4% from operating improvements alone.

"We are aggressively exiting noncore activities and consolidating underutilized sites in both Europe and North America," Paja said in a public investor presentation in June, a rarity for a privately held company. "At the same time, we are investing to capture the growth we see com' from Asia and more particularly China."



GKN's Langfang facility, which had nearly 1,000 employees in mid-2021, is one of the world's largest sites for manufacturing electrical interconnection systems. Credit: GKN

To that effect, UK-based GKN Aero is expanding its footprint in China more than tenfold to 135,000 m² (1.5 million ft.²) by 2030 and expects annual revenue generated there to grow more than fourfold to at least £270 million (\$308 million). That includes a 100,000-m² aerostructures factory opening in Jingjiang next year in a joint venture with Comac and Avic.

At the same time, the company is setting up four global "technology centers" where it will provide 3D printing and other advanced manufacturing technologies. By 2025, GKN Aerospace expects factory utilization of its remaining 11 U.S. and European plants to reach at least 95%, compared with 68% in 2020.

"The whole thing is laser-focused on value creation," Paja said of GKN Aerospace's restructuring.

The larger aerospace and defense sector can expect more of this in the coming decade, according to several industry experts, as a potentially historic wave of consolidation is expected to sweep every corner of industry.

Yet no subsector could be altered more than the largest segment, commercial aerospace, which is laboring to recover in the wake of the COVID-19 pandemic and Boeing airliner crises. The potential wave of mergers and acquisitions brings new owners to old assets and often—as in the case of industry stalwart GKN—a very different ownership style.

Top Private Equity Buyers		Top Strategic Buyers	
Company	Aerospace and Defense Acquisitions (Last 13 Quarters)	Company	Aerospace and Defense Acquisitions (Last 13 Quarters)
AE Industrial Partners	43	HEICO	15
ACP	29	BAE Systems	8
Arcline Investment Management	26	CAE	
The Jordan Co.	19	General Atomics	6
The Carlyle Group	18	Mercury	
KKR	14	Calian	
Core Industrial	11	Kratos Defense & Security	5
Enlightenment Capital	10	COMSovereign	
Sagewind Capital		Latecoere	
Madison Dearborn Partners	8	Allied Motion	
GenNx360 Capital Partners	7	Jacobs	

Sources: CapIQ, Dacis, Market Research, Janes Capital Database

The different owners range from the classic “strategists,” i.e., another company in the industry, to venture capitalists that have entered aerospace and defense at unprecedented levels over the last decade. But private equity firms account for the largest proportion of aerospace and defense buyers, at 41% of deal volume in recent years, according to Janes Capital Partners.

[Private equity investment in aerospace and defense has doubled](#) over the past five years. They have amassed “unprecedented” amounts of “dry powder,” or funds to spend from their own investors, according to Greg Van Beuren, managing director in Houlihan Lokey’s aerospace, defense and government practice. Just five private equity firms focused on the sector have raised \$17.1 billion alone since 2021. “[Private equity] is a significant driver of volume in our sector,” he says.

Melrose’s acquisition of GKN, worth a total enterprise value of \$12.3 billion, was contentious because it involved a private equity firm taking over a publicly traded national jewel, and it came as other British aerospace and defense companies such as Cobham and Ultra Electronics were sold as Brexit shook businesses. GKN’s history spans centuries, including manufacturing the Spitfire fighter in World War II.

But Melrose executives saw GKN as largely inefficient. It never was well integrated, could not benefit from economies of scale and included many siloed units that did business differently, they say. What they are doing to improve GKN’s performance may mean massive changes, but the strategy is classic private equity, and GKN is responding as they expected.

Permanent annual cost savings could begin at £150 million. While the pandemic-induced shift to narrowbody from widebody aircraft meant the private equity owner had to make more profound changes than it first expected, managers say GKN will be “extremely well positioned” to ride a recovery because it already was restructuring. “Most of the riskier operational changes are complete, or at least are broadly underway,” Melrose CEO Simon Peckham says.

Largest Private Equity Acquisitions		
Private Equity Group	Total Disclosed Value (U.S. \$ Billions)	Key Acquisitions
Melrose	\$12.3	CKN
The Carlyle Group	9.3	ManTech StandardAero
Advent International	7.8	Cobham Safran Identity and Security
Veritas Capital	7.6	Cubic Peraton Northrop Grumman Federal IT Mission and Support
KKR	6.2	Hensoldt Novaria Group
The Blackstone Group	5.6	Signature Aviation Amergint Draken
Platinum Equity	1.9	Wesco Aircraft PattonAir
Francisco Partners	1.5	Forcepoint
CVC	1.3	Ontic
Total Disclosed Volume: \$53.5 billion		

Sources: CapIQ, Dacis, Market Research, Janes Capital Database

The playbook is being repeated across the industry. Private equity investors CIC Partners and Juniper Capital Management teamed to buy Applegate EDM and Icon Machine, both in the Dallas area, to create a new portfolio company called Precision Aerospace that focuses on exotic and precision metal work for defense and commercial space.

Details of the deals, announced in August, were not provided. But Precision CEO Pete Stegmaier and Juniper co-founding partner Bryan Grabowsky tell Aviation Week they are in talks with other target acquisitions.

“This will be a robust platform, with numerous assets acquired over the next few years,” Grabowsky says. “We’ll probably get a little bit more exposure to commercial aerospace.”

Applegate, founded in 1993, provides electrical discharge machining (EDM), focusing on complex geometry in specialty and exotic metals. It operates out of a 30,000-ft.² facility in Dallas. Icon provides precision machining and manufacturing, specializing in critical, tight-tolerance parts and components with an emphasis on small and difficult geometries for major aerospace and defense contractors. Icon was founded in 1999 and operates out of a 20,000-ft.² facility in Irving, Texas.

Applegate and Icon were both founder-run companies that were performing well with good “scorecards” from top-tier contractor customers, according to Stegmaier and Grabowsky. But like many small manufacturing companies, they faced an inflection point with sunseting programs and new-technology investment needs. In turn, they sought financial sponsors to sustain their businesses.

That is a common entry point for private equity investors. “There’s some sort of catalyst that is requiring potentially a new owner to come in,” Grabowsky explains. “And sometimes those things are pretty obvious that something just needs to change to really unlock where this business could be in two or three years.”

The good news, according to Alex Krutz, founder and managing director of Patriot Industrial Partners, is that the days of private equity acting as a corporate raider—that would buy companies, load them up with debt, break them up and sell them off—are past. He posits that today’s private equity investors and their deal counterparts all have learned that highly leveraged aerospace and defense assets do not do well, mostly because the business requires intense funding needs for factories, workers and business processes. Private equity owners provide more equity in general. Also, debt costs are rising as central bank interest rates rise.

“There’s going to be a little bit more equity going in versus debt, taking that longer-term approach,” Krutz says. New owners are making investments in additive manufacturing, automation and digitalizing work functions, as GKN exemplified. “Old machines and underutilized assets are being phased out,” he notes. “And I’m not even talking about the distressed and bankrupt businesses. . . . The remaining assets are going to be better positioned for future programs.”

How Melrose Is Restructuring GKN		
UK	Closed: Kings Norton site	Complete
Nordics	Downsizing: Norway site Refocusing: Creation of distinct and separate product centers of excellence in Sweden and Norway	~50% complete, on track
Netherlands	Closing: Helmond and Hoogerheide sites	Announced 2022 first quarter, on track
U.S.	Closing: St. Louis, Amityville and Manchester sites Downsizing: El Cajon, Orangeburg Divested: Non-core Santa Ana facility (complete)	Announced 2022 first quarter, on track
Other	Divested: Fokker Services and Fokker Techniek Closed: Subscale Thailand site	Complete
Transforming footprint down to 33 manufacturing sites		

Sources: Melrose Industries

Private equity firms such as Precision Aerospace’s new owners echo the point. “We don’t have typical private equity hold periods,” stresses Grabowsky. “We could own this asset for a long period of time.”

Of course, change does not benefit everyone equally. The previous owners lose autonomy over their businesses. Some workers will lose their positions involuntarily, including at long-term employers. What is more, the overall industry may be left without enough capacity to meet production-rate increases, Krutz says, as the cumulative effects of consolidation are not accounted for in individual deals that are made only for the interests of buyers and sellers.

For their part, new GKN Aerospace owner Melrose is more excited about future prospects than it expected. Aerospace has the highest potential equity return of all the GKN businesses, with a compound annual growth rate of at least 7% through 2030 and 10% through 2025.

“Aerospace is a better business than we thought, with a higher upside,” Melrose Chief Financial Officer Geoffrey Martin says.