

GD's Force Protection Buy A Sign of Consolidation

By ZACHARY FRYER-BIGGS

General Dynamics' announcement that it had reached an agreement to purchase armored vehicle maker Force Protection is expected to be part of a period of heavy consolidation around small and midsize contractors, as the defense industry hunkers down to face spending cuts.

In September, United Technologies agreed to buy Goodrich, although analysts say that the U.S. Department of Defense has little appetite for mergers among top 20 defense companies.

"Lots of folks have thought about buying it [Force Protection], and right now, it makes all the more sense because there absolutely has to be consolidation in this industry," said industry analyst Jim Hasik of Hasik Analytic. "You have to look at what the probable spending patterns will be worldwide for armored blast protection, and it's not good. The wind is really coming out of the sales of that market."

Force Protection, a South Carolina-based company best known for its Cougar and Buffalo mine-resistant, ambush-protected (MRAP) vehicles broadly deployed in Afghanistan, was ranked No. 92 in the Defense News Top 100 for 2010 after dropping more than 30 percent in revenue from 2009. It will be acquired for \$5.52 per share, or about \$360 million, a price that has drawn criticism for being either too high or too low.

In a not atypical development, a number of law firms have announced the initial stages in what might become class action suits against Force Protection for agreeing to the sales price.

On the other end of the spectrum, some analysts are questioning whether General Dynamics, ranked No. 5 on Defense News' 2010 list, will be able to extract substantial value from the deal.



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On the Same Team: General Dynamics will buy Force Protection, which makes armored vehicles including the mine-resistant, ambush-protected Cougar.

"If the recent historical profitability of the company is indicative of its propensity for profitability in the future, then General Dynamics is probably overpaying," said Steve Grundman of Grundman Advisory.

However, Grundman said the acquisition might make sense if viewed as largely a technology purchase.

"Force Protection does have great technology in this segment, so maybe what General Dynamics has in mind is to leverage Force Protection's technology into other customers, and other segments," he said.

There will be a market for that technology, Hasik said.

"New production is falling through the floor, but there is a need to recapitalize equipment that's capped out from service in Iraq and Afghanistan," he said. "When you do recapitalization work on our vehicles, you're going to want survivability improvements, and the thought is that Force Protection has some impressive technology, and it seems that they have been focusing on that aspect of their business because they knew that they were not going to compete with Navistar as a truck manufacturer."

Analysts also pointed to a number of non-U.S. market

opportunities, including the Canadian Tactical Armored Patrol Vehicle project, the Australian Land 121 competition and the British Light Protected Patrol Vehicle program.

General Dynamics and Force Protection had teamed up previously for a joint MRAP effort under the Force Dynamics moniker.

In a conference call to announce the acquisition agreement, Force Protection CEO Michael Moody said that he had full confidence that his company would be given the opportunity to continue its development under General Dynamics.

"It's clear to me that General Dynamics is buying Force Protection to help grow and develop our business, not to dismantle or shut it down," he said. "They recognize that it's much harder to create rather than destroy value, and they plan to leverage our skilled work force to help drive future success."

In a news release from General Dynamics, the company's land systems division president, Mark Roualet, emphasized the expansion of product offerings as a result of the deal.

"Force Protection complements and strategically

expands General Dynamics' armored vehicle business, adding new products to the expansive portfolio of combat vehicles that we currently manufacture and support," he said.

"In addition, Force Protection's skilled work force provides high-quality support and sustainment services to an installed fleet of approximately 3,000 vehicles, strengthening our ability to support assets deployed with U.S. forces around the world," Roualet said. "With this acquisition, we will create new opportunities to serve domestic and international customers alike."

Because General Dynamics reported having more than \$1.5 billion in cash at the beginning of October, and Force Protection's more than \$120 million in cash essentially lowers the net purchase price to roughly \$240 million, the price won't be an issue for General Dynamics, Grundman said.

"In many ways, the price is a rounding error for General Dynamics," he said. "What's interesting is the strategy for General Dynamics."

That strategy emphasizes acquiring competitors, Grundman said.

"In this case, it's a little bit harder to say that they're taking a competitor out of the market, because they alone do not have a product that competes against Force Protection," he said.

The strategy will likely need to include efforts to confront lingering reputation issues that Force Protection faces.

"Their track record has been sullied for years by a lack of responsiveness in parts management and customer service, and they did not earlier on have the most reliable vehicles," Hasik said.

Hasik expressed optimism that General Dynamics could remedy the issues.

"I think that GD is definitely known for responsiveness to requirements," he said. "That's one of the places that GD is going to come in to straighten things out." □

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