

Sikorsky Deal Could Presage Industry Realignment

By Andrew Clevenger 9:48 a.m. EDT July 25, 2015



(Photo: U.S. Air Force Photo/Senior Airman Willard E. Grande II)

WASHINGTON — Lockheed Martin's planned acquisition of Sikorsky Aircraft may be a harbinger of increased mergers and acquisitions (M&A) activity as defense firms reassess their business strategies in an increasingly competitive marketplace.

Lockheed ended months of speculation with its formal announcement of the \$9 billion deal last week, and at the same time indicated it would sell off some of its information technology and technical services businesses.

Some industry observers raised concerns that by acquiring the biggest American helicopter manufacturer, Lockheed, already the world's largest defense contractor and a major integrator of helicopter systems, could run afoul of antitrust strictures against too much vertical or horizontal integration.

Jeff Bialos, an M&A attorney at Sutherland who specializes in aerospace and defense, said Lockheed signaled its awareness of these possible roadblocks in its stock purchase agreement. Specifically, Lockheed indicated it would divest itself of up to \$650 million in revenues in its mission systems business unit, which includes subsystems for helicopters.

Lockheed also proposed a behavioral remedy designed to ensure its conduct in the market wouldn't be anti-competitive, he said.

"The question is whether bigger creates leverage that could be used anti-competitively," he said.

On a call with investors last week, Gregory Hayes, CEO of Sikorsky parent company United Technologies, said valuations put Sikorsky's worth at \$5 billion, and he believed he could sell it for \$6 billion. Even with \$1.9 billion in tax benefit, Lockheed is poised to pay \$7.1 billion for the helicopter maker.

This doesn't necessarily mean Lockheed is overpaying, Bialos said.

"When companies evaluate mergers, they will look at what additional revenue they can get from the synergies, and they'll have some specifics, so they might think that they can leverage additional systems on their platforms, or logistics or services work on their platforms, and that would grow the revenue effect of owning Sikorsky," he said.

Steve Grundman, a former Pentagon industrial policy chief who is now a consultant and member of the Atlantic Council, said he doesn't see any obvious deal-breakers, but he expects that antitrust regulators in the Department of Justice will subject the purchase to close scrutiny. Should the deal go through, it would not mean that regulators — or top industrial policy officials inside the Pentagon — have established a precedent and given the go-ahead to similarly sized deals in the future, he said.

"The potentially precedential character of this merger for corporate strategy is it may signal other companies that the marketplace for large systems integration is gone; if you want to be a major prime contractor in the US defense market going forward, you're going to have to bring a platform," he said.

In a previous era of defense contracting, large systems integration, or the ability to offer your customer a solution to any military equipping challenge, was seen as a successful business model, he said. Now, the Pentagon has signaled that it wants to serve as its own systems integrator and no longer wants to outsource that function to industry.

"The marketplace for large systems integration is gone. So if you want to be a prime contractor in this market, you have to have platforms. And if you don't have platforms, you have to be able to assure yourself you can get preferred access to strategic platforms."

This helps explain why a company like Lockheed, which does not have recent experience producing helicopters, would want to acquire Sikorsky, he said.

"If you're a company like Lockheed Martin, and you want to sustain your position in prime contracting in a broad rather than a narrow scope of products, you need platforms now. Just saying, 'I'll system-integrate any problem you got' is not competitively tractable anymore," Grundman said.

Andrew Hunter, director of the Defense-Industrial Initiatives Group at the Center for Strategic and International Studies, said the deal fits with the defense industry trend of reshaping portfolios to focus on core efficiencies.

"In Lockheed's case, certainly they are at the top of the chain in most of the markets they are in, and acquiring Sikorsky lets them do that in a new market area where they've played, but they haven't necessarily been the platform integrator," he said. "For the industry generally, it seems to me that there's quite a diversity of strategies out there, both business strategies and market positioning strategies."

The common thread is that companies seem to be focusing on specialization as opposed to the conglomerate approach, he said.

Byron Callan, an analyst with Capital Alpha Partners, said the Sikorsky acquisition marks a change of strategy for Lockheed.

"By buying Sikorsky, they've realigned themselves with the single platform" model, he said. Possible explanations could include Lockheed trying to diversify its portfolio over concerns about the future of F-35 and the possibility that its entry (together with Boeing) in the competition for the Air Force's long-range strike bomber, or LRS-B, will not win.

"Is this another signal that the systems integration model, where you had proprietary architectures, is going away?" Callan mused. "The Air Force in particular is trying to open up more open architectures, so your value isn't building a proprietary network, it's in building the subsystems and platforms that you plug into that network."

More and more firms are getting out of services businesses, he said.

"The underlying dynamic of the services businesses facing more competition, they were hardly the first people to reach the same conclusion," Callan said, noting that BAE Systems had recently announced it is exploring options for shedding its services business in its US Intelligence and Security Unit. Callan also pointed to the SAIS/Leidos and Engility/L-3 splits as examples.

Email: aclevenger@defensenews.com (<mailto:aclevenger@defensenews.com>)

Read or Share this story: <http://defnews.ly/1MOyplU>

MORE STORIES



[GOP Hopefuls Joust With Obama Officials on Iran Deal](#)
[\(/story/defense/policy-](#)

[/story/defense/policy-budget/congress/2015/07/29/cruz-graham-grill-obama-officials-kerry-carter-moniz--iran-deal/30851845/\) budget/congress/2015/07/29/cruz-graham-grill-obama-officials-kerry-carter-moniz--iran-deal/30851845/\)](#)

July 29, 2015, 6:25 p.m.



[Latvia, Lithuania To Raise Defense Spending](#)

[\(/story/defense/international/europe/2015/07/29/latvia-lithuania-raise-defense-spending/30843863/\) \(/story/defense/international/europe/2015/07/29/latvia-lithuania-raise-defense-spending/30843863/\)](#)

July 29, 2015, 4:48 p.m.



**Boeing Rolls Out First Growler
for Australia**

(/story/defense/air-
space/2015/07/29/boeing-rolls-

out-first-growler-
australia/30845221/)

July 29, 2015, 5:19 p.m.

rolls-out-first-

growler-

australia/30845221/)