INTERVIEW

Lucy Reilly Fitch

Senior Vice President, Acquisitions and Strategy BAE Systems North America

BAE Systems North America now stands tall among the major DoD primes as a primary dealmaker in the defense sector. The $5 billion subsidiary of London-based BAE Systems plc will soon have completed five M&A transactions this year, including the recent acquisition of publicly traded DigitalNet (DNET:NASD). BAE NA represents about 25% of the parent group's revenue, and is the fastest growing segment within the firm.

DM&A's Paul Serotkin, writing in his role as president of defense tech investment bank Minuteman Ventures, talked recently with Lucy Reilly Fitch about BAE's M&A process, structure and plans. Ms. Fitch manages mergers, acquisitions, divestitures and strategic planning.

DM&A: BAE Systems NA has become increasingly active – and successful – as an acquirer. Is this part of a structured plan?

LRF: Yes. Acquisitions are a key element of our corporate strategy. And recently, we have become much more aggressive. Last year our North American Executive team—both corporate and within our four sectors—committed to grow in 2004 by 15% through acquisitions, in addition to our annual goal of 10% organic growth, a goal we have met. That caused us to focus harder on M&A and, in the process, re-align our 'M&A infrastructure.'

DM&A: How so?

JF: BAE NA has historically been decentralized in our M&A pursuits. Now, the Sector presidents are as committed to external growth as before, if not even more so, but the acquisition program is increasingly led more by North America corporate headquarters in a centrally structured manner.

North America Corporate and its functional leads tend to prosecute the deals, but work hand-in-glove with the Sector teams in executing the due diligence process and identifying potential targets of interest. We leverage our Sector teams in a more subject matter expert role, seeking sophisticated guidance from them on the viability of particular targets, as well as having them lead the integration process.

DM&A: How is BAE Systems NA's Corporate M&A function organized?

LRF: We have the equivalent of about 12 FTEs throughout the enterprise working on M&A, with another dozen or so supporting the M&A process on a case-by-case basis.

DM&A: What types of companies does BAE Systems seek to acquire?

LRF: Companies that complement our technologies and program expertise in supporting the national security and aerospace markets. Specifically, we're looking for those companies which provide differentiators in electronic and information-based systems or knowledge-based systems.

To the extent they support the warfighter directly or meet National Security goals, inside and outside of DoD (including such non-defense agencies as DHS, NASA, and other departments to include Justice, Transportation, and so on), they come up on our radar.

Technology-rich firms rank high, regardless of size. Witness our acquisition this year of STI Government Systems and Practical Imagineering.

About 75% of our business is in C4ISR; most of these companies support that broad mission. They also enable us to challenge the 'Big 5' DoD primes in major system developments.

DM&A: How do you see the current M&A environment in the defense sector?

LRF: Very active, and which we believe will intensify in 2005. Our data shows that, based on deal volume

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Offerings

B/E Aerospace, Inc. (NASDAQ: BEAV), announced the pricing of an offering of 16.0 million shares of its common stock at a price of $9.00 per share through Credit Suisse First Boston and UBS Investment Bank as joint book running managers and Jefferies Quarterdeck and Stephens Inc. as co-managers. The underwriters also have an option to purchase up to an additional 2,400,000 shares to cover over-allotments, if any.

The company has 444.89 million shares outstanding. The sale of 16 million shares would expand this total by 3.6 percent, to 460.89 million shares. If the full overallotment option of 2.4 million shares were exercised, the total would expand by 4.1 percent, to 463.29 million shares.

If fully subscribed, the offering will have gross proceeds of $144-$165.6 million, depending on whether overallotment options are exercised.

Nuts and bolts

RTI International Metals, Inc. (NYSE:RTI) signed an agreement to acquire **Claro Precision, Inc.** of Montreal, Quebec, Canada

Founded in 1996, Claro is a manufacturer of precision-machined components and complex mechanical and electrical assemblies for the aerospace industry. A significant portion of Claro's high value-added parts are produced for regional and business jet programs at Bombardier, the Canadian aircraft manufacturer.

Claro's annual revenues are approximately C$20 million ($15.7 million). The company has 130 employees.

Advanced Products Corp. (APC), a newly formed Delaware Corporation owned by **AMT II Corp.** and **Kline, Hawkes & Co.**, a Los Angeles-based venture capital company, acquired a majority interest in **Vermont Composites, Inc.** of Bennington, Vermont.

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for the first six months of 2004, DoD merger activity will hit levels this year not seen since pre-9/11.

M&A will become an increasingly evident strategy for companies that wish to aggressively grow within the U.S. government market. A primary driver of that is the fact that DoD's budget is projected to grow at 4.5% CAGR, while BAE Systems NA and many other DoD contractors are seeking growth of 10-20% per year. That kind of rapid growth for large companies cannot be achieved without acquisitions.

The market remains ripe for consolidation, particularly in the Tier 3 group. (Ed. Note - She defines Tier 3 as companies with under $1 billion in revenue.) Cash reserves for several of the large platform companies are in excess of $3 billion, combined with declining debt levels, will increase pressure on them to deploy cash in ways beyond dividends.

Though we expect public and M&A valuations in defense to soften at some point, the combination of excess cash, slowed DoD budget growth and low cost-of-capital environment, will continue to drive robust M&A activity.

DM&A: Has foreign ownership in anyway constricted BAE Systems NA's growth in the U.S.?

LRF: To the contrary, we are readily accepted as part of the fabric of the DoD industry. Our Special Security Agreement, in place with DoD since 1985, has become the benchmark on how to address foreign ownership of companies doing business with the Pentagon. *(Ed. note – indeed, about 50% of the BAE Systems PLC stock, traded on the London Stock Exchange, is held by U.S. institutions)*. The ultimate evidence of our acceptance is the large amount of classified work BAE Systems NA performs for DoD as well as our customer survey results.

DM&A: Describe BAE Systems NA's operating philosophy on how it introduces acquired companies into the fold.

LRF: We tend to assimilate, rather than integrate. This is especially pertinent in that we are absorbing technology-rich firms. Our fervent goal is not to quash their innovation, which is why we acquired them in the first place.

However, on (deal) closing day, we do change the acquired firm's name and bring them into the BAE Systems family.

DM&A: Other than technology, are there cultural aspects of target firms that appeal to BAE Systems NA?

LRF: Our culture is very end-user centric. We focus heavily on our relationships and understanding the end-user, which for the most part are the men and women in the Armed Forces. We seek companies that share the same mindset. Above all, we view ourselves as patriots and protectors of our National Security writ large, and look for the same from the acquired firm's employees. One of our business units coined the phrase, "We protect those who protect us." That concept—the concept of focusing on the end user and being a trusted partner to provide innovation and best-value solutions—is something we take very seriously, and look for our newly acquired entities to embrace as well. ❖