

BAE Asset Sales May Support Drive for U.S. Contracts

By Howard Mustoe and Andrea Rothman - Sep 13, 2010

BAE Systems Plc's plan to sell as much as \$2 billion worth of U.S. aircraft and vehicle controls may help Europe's largest arms company focus on defense services and raise cash for potential purchases. BAE has hired Wells Fargo & Co. and JPMorgan Chase & Co. to explore option for the so-called platform solutions business, including a possible sale, the London-based company said today in response to reports of a planned disposal. The unit include hybrid propulsion systems for buses and trucks as well as flight controls used by Airbus SAS and Boeing Co.

"They may be assembling a war chest for acquisitions in the defense and security services, both areas they want to build up in," said Zafar Khan, an analyst at SG Securities in London, who advises investors buy BAE shares. "But they may also want to remind people how much their portfolio could be worth, given that the stock has fallen so much."

BAE's North American subsidiary has a "large pipeline of targets" it's working through, regional head Linda Hudson said in July. BAE has bolstered maintenance operations with purchases including Atlantic Marine Holding Co. in May for \$352 million that serves the U.S. Navy, as the company tries to strengthen its foothold in the world's largest defense market.

The London-based company had 2.49 billion pounds (\$3.82 billion) of cash as of June 30 and 1.2 billion pounds of debt. In a statement today, BAE said it regularly reviews its business structure. First-round bids for the assets are due within the month, two people with the plan said yesterday, who declined to be identified as details have not been made public.

London Buses

U.S.-based Platform Solutions, part of BAE's electronics, intelligence and support division, employs 4,200. The hybrid technology runs in more than 2,000 buses in North America as well as some new models of London's iconic double-decker red buses, while another unit makes

aircraft-engine controls for General Electric Co., the people said. In recent months, BAE has accelerated an overhaul of its operations. In June, BAE sold half its 21 percent stake in Saab AB, the Swedish maker of the Gripen warplane, for 1.04 billion kronor (\$140 million). On Sept. 9, BAE said would cut about 740 U.K. jobs at the division supplying parts for military aircraft such as Lockheed Martin Corp.'s F-35 Lightning II.

BAE shares have fallen 10 percent so far this year, more than Lockheed, whose stock has fallen 6.6 percent. Northrop Grumman Corp., the third-largest U.S. defense contractor, has gained 5 percent since the start of the year. Virginie Vacca, an aerospace and defense analyst at Standard & Poor's in London, said the company can add more value in systems integration than with making equipment.

War Chest?

"The key challenge in a defense contract is often not to produce the different parts, but to make it all work together and match demanding requirements," said Vacca, who has a "buy" recommendation on BAE. While many contractors can steer satellite communications or build unmanned aerial vehicles, only some can make the two work together with specific requirements. "They do manufacture equipment, but it wouldn't surprise me if they divest more and more," she said. BAE is probably bolstering funds for acquisitions to build up its position in the U.S., said Richard Abouafia, vice president at the Teal Group, an advisory firm in Fairfax, Virginia. That market has become more critical as the U.K. government and others suffer budgetary constraints, he said.

The U.K. is due to complete its review of defense and security capabilities by the end of next month to help cut a record budget deficit. Among programs under consideration is the plan to build two aircraft carriers, and BAE said Sept. 8 that options on ships range from having two vessels to having none.

Rover Cars

Selling some operations may help BAE tidy up its portfolio after inheriting the units with the purchase of the Marconi electronic defense unit in 1999 from Britain's General Electric Co. BAE's fly-by-wire system was used by Boeing Co. in its 777 model, the first Boeing plane to that technology. The controls are also used on Airbus A320 planes, on Boeing's C-17 transport and Lockheed's F-18 and F-35 planes.

BAE, known as British Aerospace until it brought the Marconi business and changed its name, has gradually retreated from non-defense-related assets in the last decade to focus on military applications. BAE sold its Rover cars unit as well as a construction business in the 1990s, and in the last decade has discarded much of its commercial aerospace business. In 2002, BAE quit building Avro regional jet planes,

and the company sold its aerostructures business that made wing parts for Boeing and Airbus planes to Canadian buyout company Onex in 2005. A year later, BAE sold its 20 percent stake in Airbus to European Aeronautic, Defence & Space Co.

Still, putting the avionics business on the block could prove ill-timed as demand for commercial aircraft rebounds, said William Alderman, president of Alderman & Co. Capital, a broker dealer specializing in aerospace and defense in Ridgefield, Connecticut. "This does not send a clear signal to me about what BAE is thinking," Alderman said. "We believe the commercial avionics segment is headed into an up market over the next 2 to 5 years, while North American defense will be flat at best for the next 2 to 5 years"