



## Industry Commentary

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## U.S. Military Pilot Shortage Creates Outsourcing Opportunities, M&A Interest for Defense Contractors

Faced with an unprecedented and growing pilot shortage, the U.S. military is expanding its outsourcing of aggressor support training and other forms of pilot training, transport, ISR, and other services, leading to intense M&A interest in these companies from potential acquirers.

In 2016, United States Air Force Chief of Staff Gen. David Goldfein called the shortage of pilots facing the U.S. military a “quiet crisis.” At the time, the Air Force projected a shortage of more than 1,500 pilots; since then, the crisis has only gotten louder.

In the fall of 2017, the Air Force reported that the pilot shortage had grown to nearly 2,000—or 10% of the Air Force’s full authorized strength.

“We are in a crisis,” Gen. Goldfein said at a September 2017 meeting of Air Force senior leaders. “If we don’t find a way to turn this around, our ability to defend the nation is compromised.”

The pilot shortage has broad implications for how the U.S. military must think about training and staffing for a host of mission-critical aerial operations. Outsourcing training to private-sector companies is becoming a vital part of this new strategy. The Air Force is expected to issue a solicitation for 40,000 hours of aggressor support (a.k.a. red air) training across 12 different bases. The pilot shortage is also causing the military to increasingly

use contractors for air transport; intelligence, surveillance, and reconnaissance (ISR); follow-on services; and other areas of aerial operations support.

The military’s increasing reliance on private-sector companies to solve long-term structural force issues represents a major growth opportunity for smaller, specialized companies, as well as for large, diversified government-services contractors. As a result, there has been increased M&A activity in the industry, as strategic acquirers and financial sponsors alike look to capitalize on this trend.

### **Causes of the Pilot Shortage**

Faced with a pilot shortage of its own, the commercial airline industry has become increasingly aggressive in offering compensation packages to attract military pilots to join the private sector. Because of the growth of air travel, the commercial airline industry will need approximately 637,000 new pilots over the next two decades, according to a Boeing analysis. Lucrative private-sector opportunities, combined with growing

demands in terms of deployments being placed on military pilots, are making it harder for the U.S. military, especially the Air Force, to retain pilots.

“This confluence of circumstances has birthed a national aircrew crisis,” Lt. Gen. Gina M. Grosso, Air Force deputy chief of staff for manpower, personnel, and services, told Congress in 2017.

To combat this retention problem, the Air Force is implementing a multipronged approach that involves increased pay and bonuses, more flexibility surrounding deployments, reduced administrative demands, and improved volume and efficiency of training.

### Rationale for Outsourcing

The most important driver of the Air Force’s push to outsource aviation support is that the Air Force simply

does not have the resources to meet the demands internally. In addition to capacity constraints, there are several other reasons that outsourcing makes sense strategically for the Air Force.

As the conflicts facing the U.S. military are increasingly transregional and require complex integration among units, training and staffing models need to evolve to prepare pilots and support crew to operate successfully in these environments. Relative to relying solely on the traditional, in-house model, outsourcing enables the Air Force to innovate more quickly and operate more efficiently within mission-critical environments (e.g., pilot training and ISR support).

The outsourced model also provides better management and planning of the training process. Historically, combat units have been notorious for inflating readiness metrics and

favoring statistics that look better, but do not reflect the true readiness of a unit. With an outsourced model, the Air Force could focus on developing ways to create accountability with its private-sector partners.

Additional outsourcing would also allow the Air Force to optimize the allocation of its training resources. The Air Force’s standardized training programs do not provide new, customized training models based on each pilot’s past performance. The most innovative, technologically advanced training companies can use data analytics and other tools to adapt the training to the needs of each pilot.

The Air Force’s need to outsource training is particularly acute when it comes to combat training for red air scenarios that involve adversary aircraft. The Air Force began outsourcing red air training on a limited basis as a proof of concept at Nellis Air Force Base in Nevada in 2016. The Air Force is expanding on the success of this initial program and has issued a solicitation for 40,000 hours of contracted aggressor support training across 12 bases. A draft of the multi-award contract is expected to be released in July 2018, with the final contract coming in January 2019.

### M&A Activity

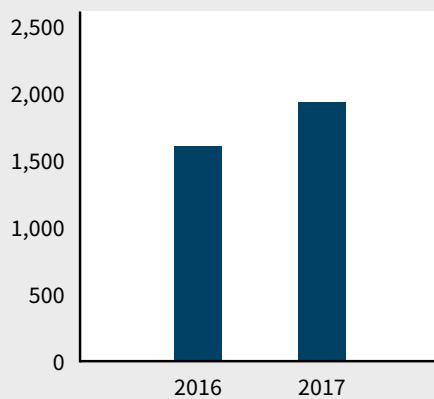
The Air Force’s strategy to increase its use of outsourcing for pilot training and other aerial operations has led to heightened levels of M&A interest from strategic acquirers and financial sponsors alike. In terms of the training function, acquirers have shown significant interest in companies that provide the actual training, as well as manufacturers of simulator equipment and software that is essential to training pilots more efficiently.

The outsourced military pilot industry is highly fragmented, and the industry’s “barbell” shape lends itself to consolidation. At one end of the spectrum, the large, diversified

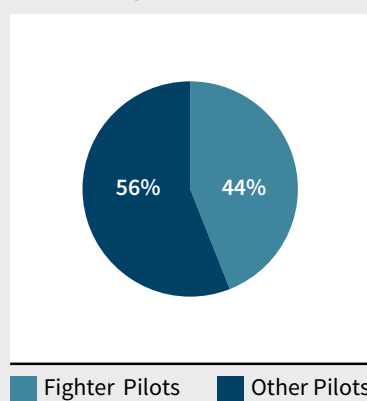
## Inside the U.S. Air Force’s Pilot Shortage

A severe pilot shortage has hit the commercial airline industry and the U.S. military. Commercial airlines’ ability to recruit military pilots to join the private sector by offering aggressive compensation packages, however, has meant that the U.S. military, and the Air Force in particular, is having to use new strategies to increase its ability to train and retain pilots. A major component of the Air Force’s strategy involves outsourcing pilot training and aerial support operations to private companies.

No. of Pilots Short of Full Strength



% of Shortage by Pilot Type



### Cost of Training Fifth-Generation Fighter Pilots

**\$11 million per pilot**

Source: U.S. Air Force estimates

government-services contractors are looking for ways to expand their aerial training and staffing capabilities by acquiring firms that have specialized capabilities and innovative technology. Meanwhile, smaller firms that have successfully differentiated themselves see opportunities to expand rapidly.

While financial sponsors have shown high levels of interest in outsourced training companies and other companies that can help the U.S. military address the pilot shortage—particularly companies that lease aircraft and have asset-light business models—large strategic acquirers have, so far, emerged as the winners in most of these M&A processes. This speaks to the high level of synergies and strategic growth opportunities that pilot outsourcing provides for diversified government-services contractors.

The heightened M&A interest in outsourced training companies is not limited to the defense sector. Commercial airlines are relying more heavily on outsourced training, in response to the pilot shortage. In March 2018, the U.S. Department of Transportation, as part of its Forces to Flyers Research Initiative, issued a solicitation for flight schools to receive federal funding to train military veterans as pilots. Initiatives such as these have added to the attractiveness of companies that provide outsourced training.

In September 2017, bankers from William Blair’s aerospace and defense team advised Doss Aviation on its sale to L3 Technologies. Doss Aviation is the sole provider of initial flight training for Air Force pilots and was recently authorized to train international military pilots. “As the demand for outsourced flight training and services increases, Doss uniquely expands our military instruction footprint, positioning L3 for growth across both military and commercial training,” said Todd W. Gautier, president of L3’s electronic systems business.

To learn more about the trends that are shaping dealmaking activity in the aerospace and defense industry, please do not hesitate to contact us.

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