

Wall Street and the Pentagon

An Annotated Brief:

The Defense Budget and Defense Industry Finance

David J. Berteau

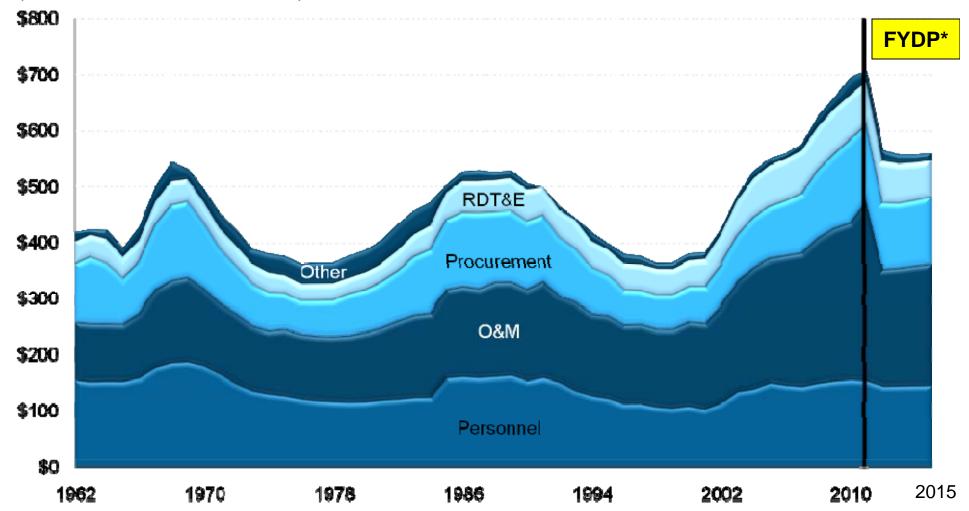
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Defense-Industrial Initiatives Group

Department of Defense (DoD) Outlays, 1962-2011

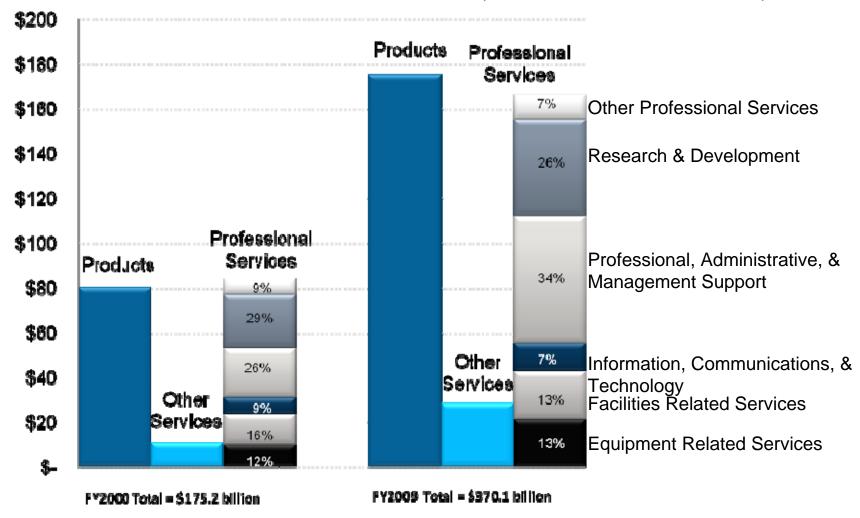
(Constant FY2010 US\$ bn)



FY1962-FY2009 = Historical Outlays; FY2010 = Budget Authority including OCO as of February 2011; FY2011 = Budget Request Including OCO * Excluding OCO

Composition of Total DoD Contracts

DoD Total Contract Dollars, 2000 and 2009 (constant FY2009 US\$, bn)



The CSIS Defense Index

- CSIS selected 23 companies that reflect the diversity of the industry supplying the Defense Department
 - Revenue: ~\$100m to \$40bn+
 - Electronics to heavy metal
 - Both products and services
- Companies added as data becomes available

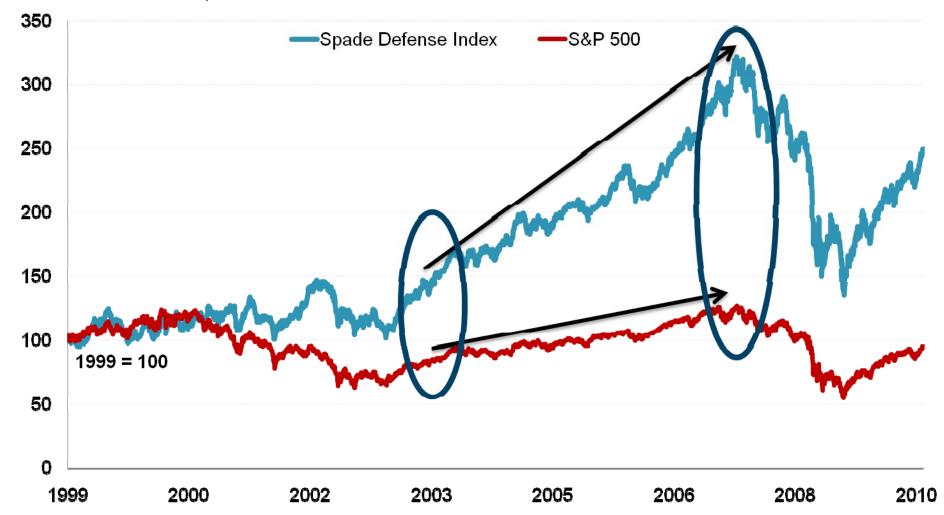
Year	87	88	89	90	91	92	93	94	95	96	97	98	99	00	01	02	03	04	05	06	07	08	09
Companies	7	8	8	9	11	12	13	13	13	14	15	17	17	17	17	17	18	23	23	23	23	23	23

 Benchmarked to S&P 1500 Industrials – broad mix of products and services and company size

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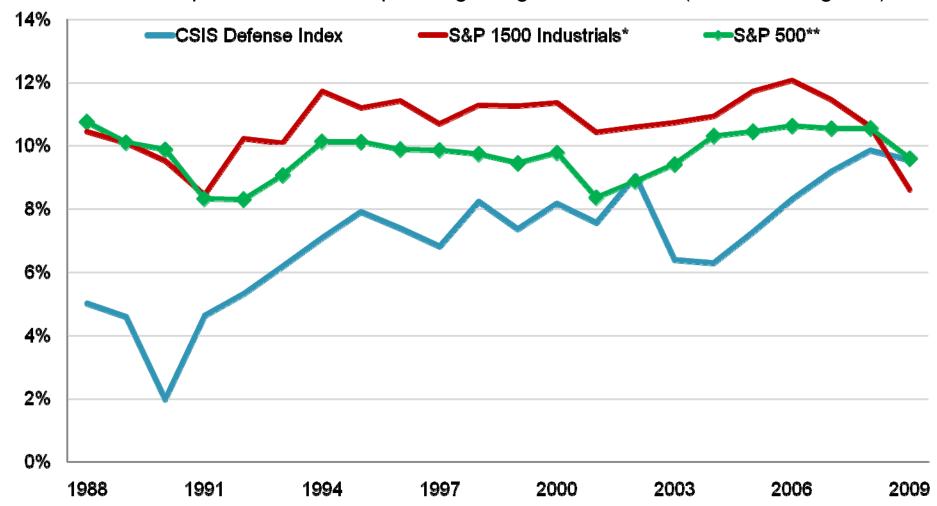
On Wall Street: Outperformance from 2003 to 2007

Index Performance, 1999-2010



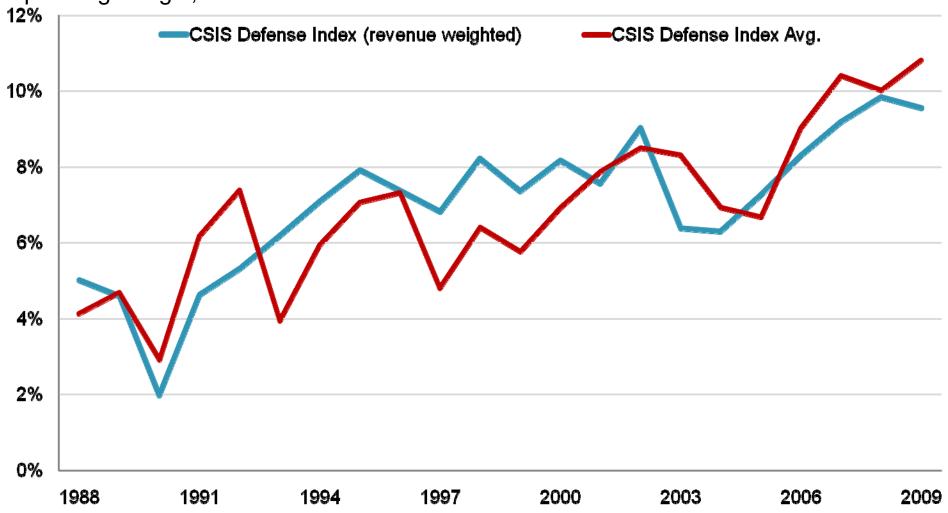
CSIS Defense Index Operating Margin are at a High

...But Lower Compared to Peers. Operating Margin, 1988-2009 (revenue weighted)



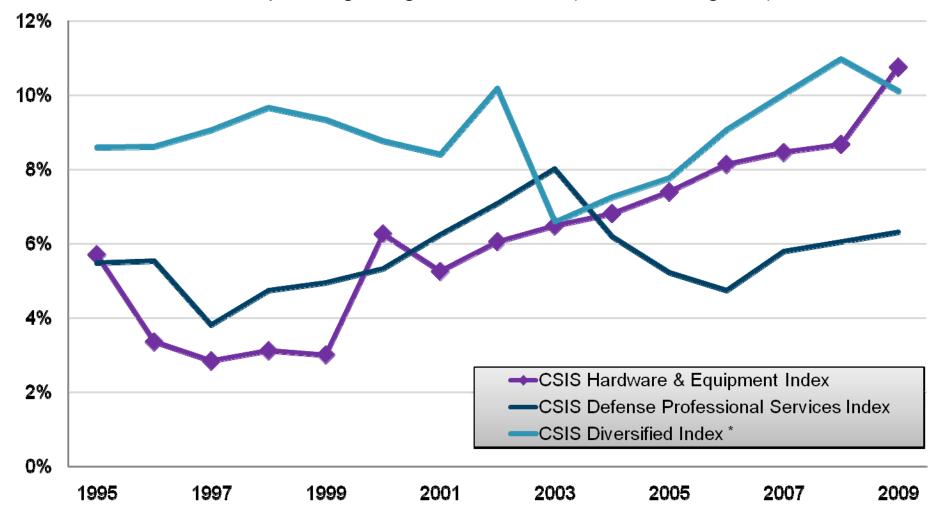
Performance Vary according to Size (by Revenue)

Operating Margin, 1988-2009



CSIS Index Performance Vary by Business Segment

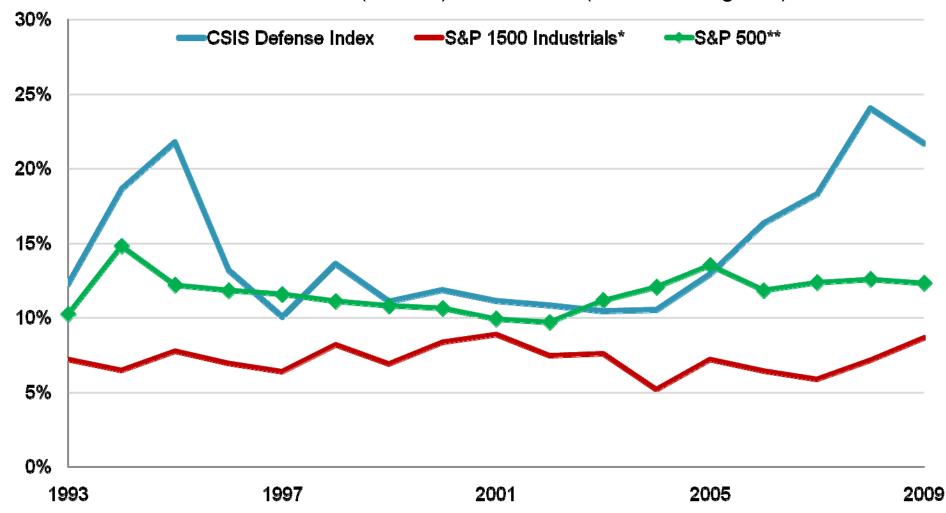
CSIS Defense Indices, Operating Margin, 1995-2009 (revenue weighted)



^{*} Companies operating in both the defense professional services and hardware & equipment spheres Source: Bloomberg, analysis by CSIS Defense-Industrial Initiatives Group

Defense Index CFROI Higher than that of Its Peers

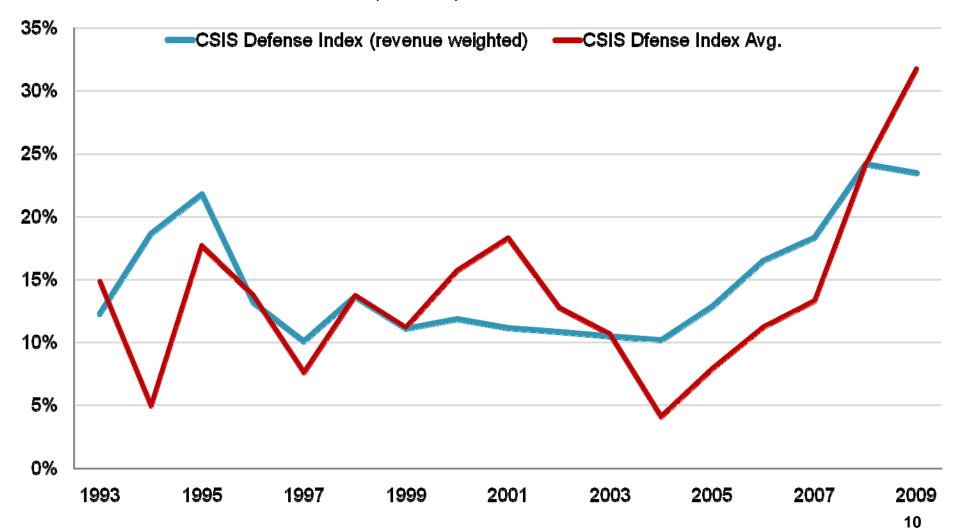
Cash Flow Return on Investment (CFROI), 1993-2009 (revenue weighted)



^{*}Excluding Defense ** Excluding Defense & Financials

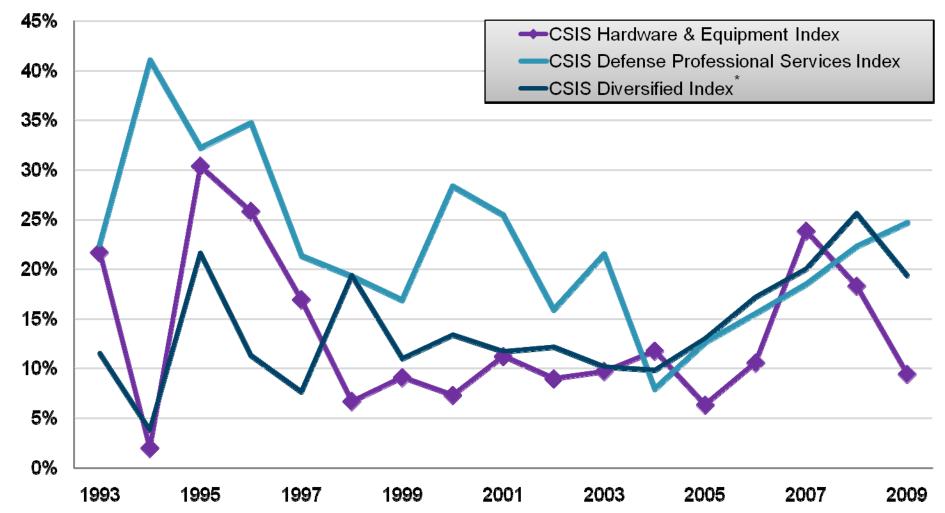
CSIS Defense Index CFROI Vary by Size

Cash Flow Return on Investment (CFROI), 1993-2009



CSIS Defense Index Performance Vary by Segment

CSIS Defense Indices, CFROI, 1993-2009 (revenue weighted)



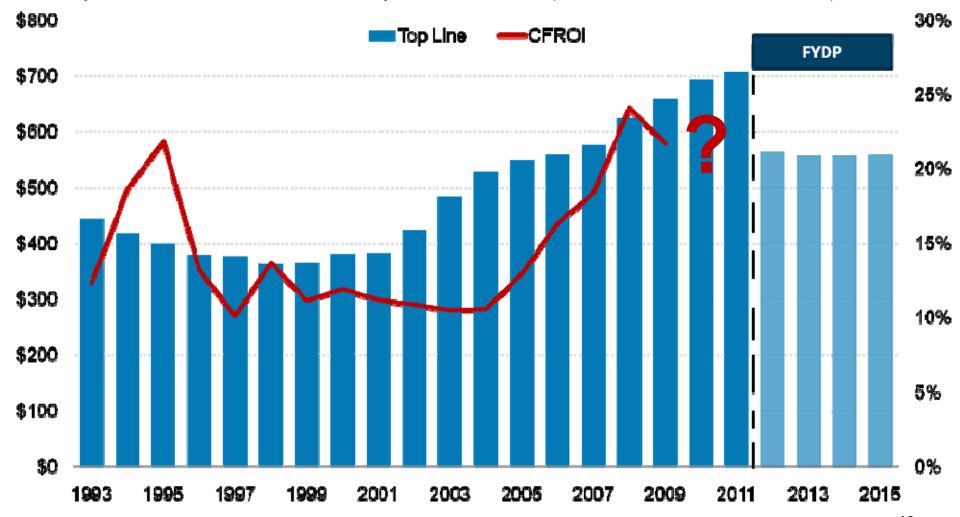
^{*} Companies operating in both the defense professional services and hardware & equipment spheres Source: Bloomberg, analysis by CSIS Defense-Industrial Initiatives Group

Key Questions

- 1. How can companies position for an era of flat / declining investment?
- Where can companies find growth?
- 3. How can companies preserve margins when their main customer is fiscally constrained?
 - a) Europe / India / elsewhere?
 - b) Continued growth in services?
- 4. How can companies return value to shareholders?
 - a) Capital utilization
- 5. Acquisitions / divestitures
 - a) What impact will the Organizational Conflict of Interest directive in the 2009 Weapon Systems Acquisition Reform Act have on business portfolios?
 - b) Is the defense merger & acquisitions climate conducive to further consolidation?
- 6. How can companies deal with global competition?

Returns Driven by Outlays?

Industry CFROI and Defense Outlays, 1993-2009 (Constant FY2010 US\$ bn)



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Since 1962, CSIS has grown to become one of the world's preeminent international policy institutions, with more than 220 full-time staff and a large network of affiliated scholars focused on defense and security, regional stability, and transnational challenges ranging from energy and climate to global development and economic integration.

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