



Defense Industry Access to Capital Markets

Wall Street and the Pentagon

Naval Postgraduate School 8th Annual Acquisition Research Symposium

Acquisition Research: Creating Synergy for Informed Change

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CSIS

CENTER FOR STRATEGIC &
INTERNATIONAL STUDIES

Defense-Industrial
Initiatives Group

Introduction:

- **Private companies rely on capital markets to finance operations.**
- **Capital markets play a role in shaping the depth and breadth of the U.S. defense industry, the capabilities it has to offer, and the cost of these capabilities.**
- **This presentation address the relative attractiveness of the U.S. defense industry is to capital markets.**

Agenda:

I. Methodology

II. Analysis

I. Profitability & Returns

II. Liquidity

III. Relative Market Valuation

III. Summary & Conclusions

Methodology:

- **The CSIS Defense Index**

AEROVIRONMENT	IROBOT CORPORATION
ALLIANT TECHSYSTEMS	KBR
BAE SYSTEMS	L-3
CACI INTERNATIONAL	LITTON INDUSTRIES *
DRS TECHNOLOGIES *	LOCKHEED CORPORATION *
DYNCORP INTERNATIONAL *	LOCKHEED MARTIN
ELBIT SYSTEMS	LOGICON *
ENGINEERED SUPPORT SYSTEMS *	LORAL SPACE & CO
FINMECCANICA	MANTECH INTERNATIONAL
FLIR SYSTEMS	MARTIN MARIETTA CORPORATION *
FORCE PROTECTION	MCDONNELL DOUGLAS CORPOPORATION *
GENCORP	NEWPORT NEWS SHIPBUILDING *
GENERAL DYNAMICS	NORTHROP GRUMMAN
GEOEYE	RAYTHEON
GRUMMAN CORPORATION *	SAIC
HUNTINGTON INGALLS INDUSTRIES	THALES
INTEGRATED DEFENSE TECHNOLOGIES *	VSE CORPORATION

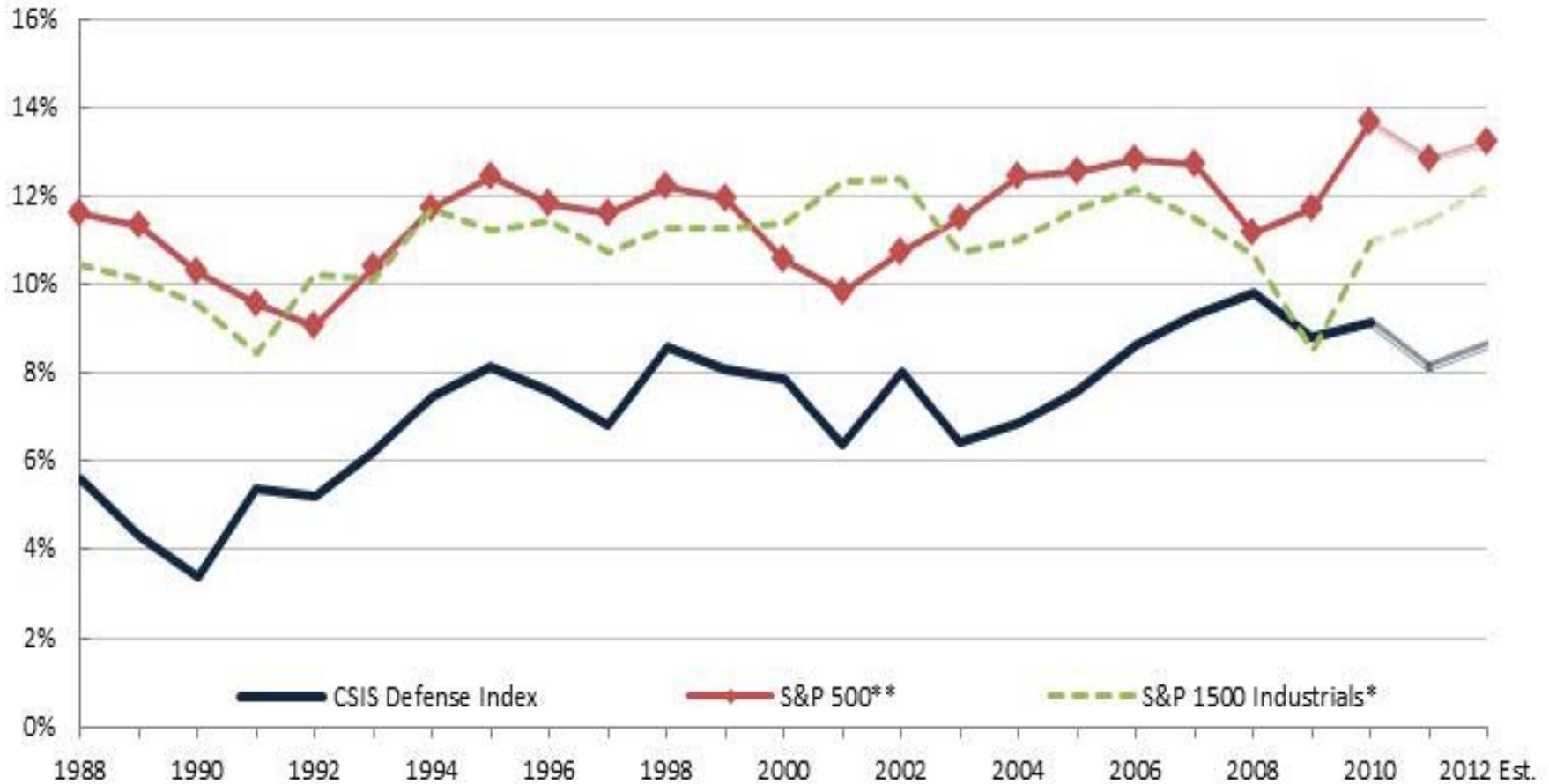
- **Commercial Benchmarks S&P 500 / S&P 1500**
- **Financial Metrics / Multiples**

Profitability & Returns:

- **Operating Profit Margins**
 - Earnings before Interest & Taxes (EBIT) / Revenue
- **Return on Invested Capital (ROIC)**
 - Net Operating Profit after Taxes / Total Invested Capital

Operating Profit Margin Comparison

CSIS Defense, S&P 500, and S&P 1500 Industrials Indices (1988-2012)

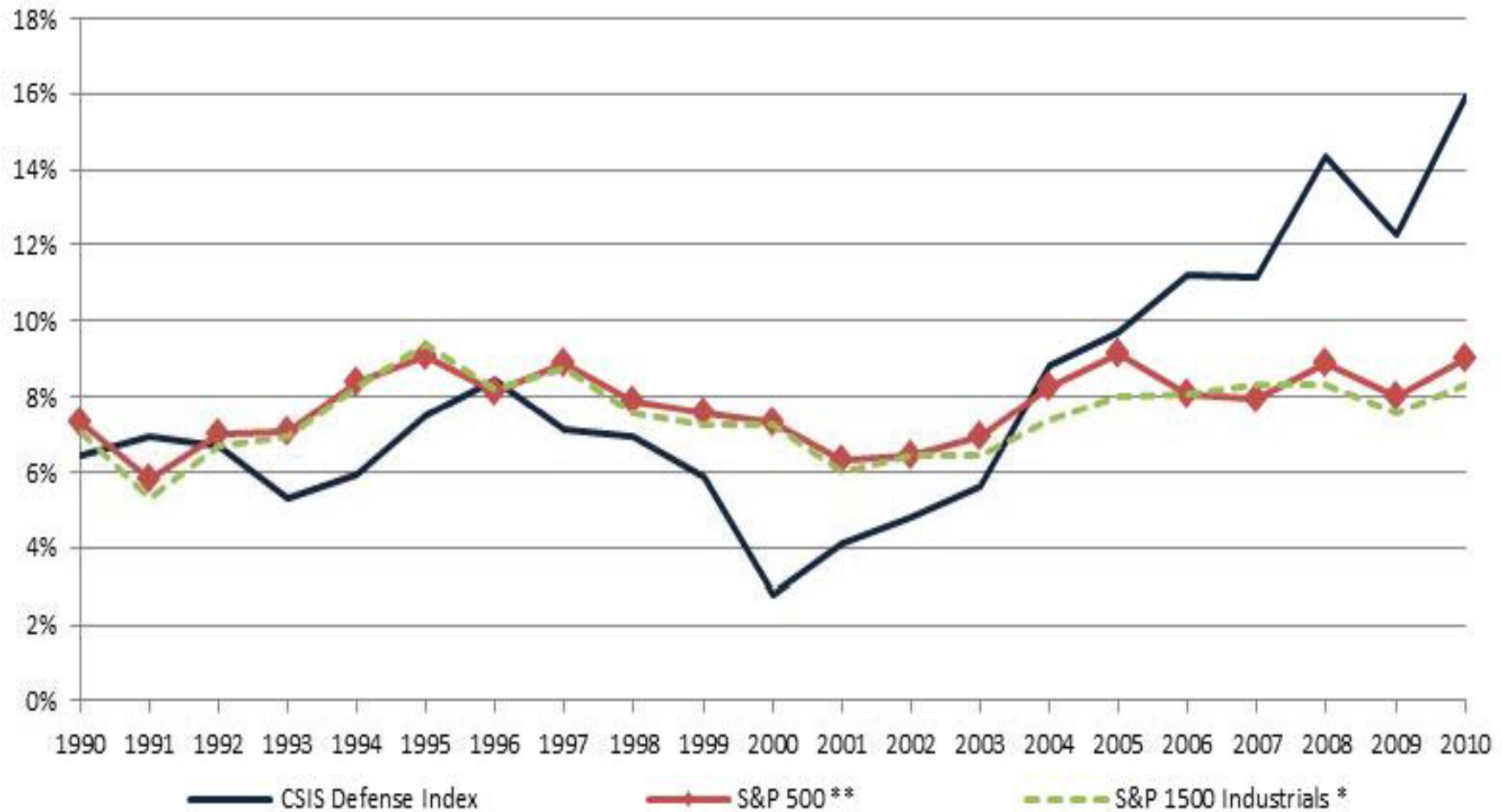


*Excluding Financials and Defense; **Excluding defense.

Source: Bloomberg, analysis by CSIS Defense-Industrial Initiatives Group.

Return on Invested Capital (ROIC)

CSIS Defense, S&P 500, and S&P 1500 Industrials, (1990-2010)



*Excluding Financials and Defense; **Excluding defense.

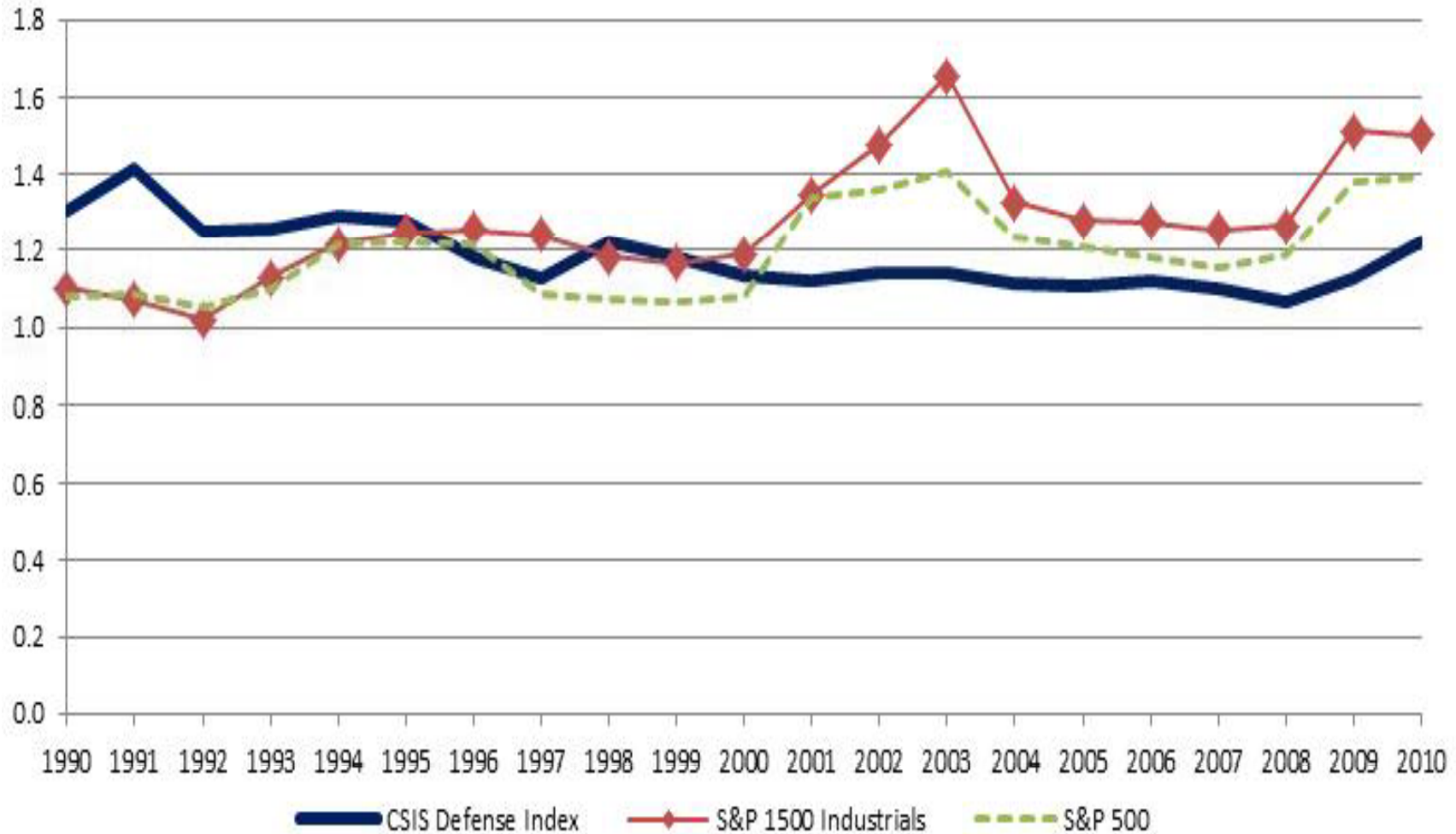
Source: Bloomberg, analysis by CSIS Defense-Industrial Initiatives Group.

Liquidity Ratios:

- **Current Ratio**
 - Current Assets / Current Liabilities
- **Quick Ratio**
 - Current Assets – Inventories / Current Liabilities
- **Cash Flow to Debt**
 - Operating Cash Flow / Total Debt

Current Ratio Comparison

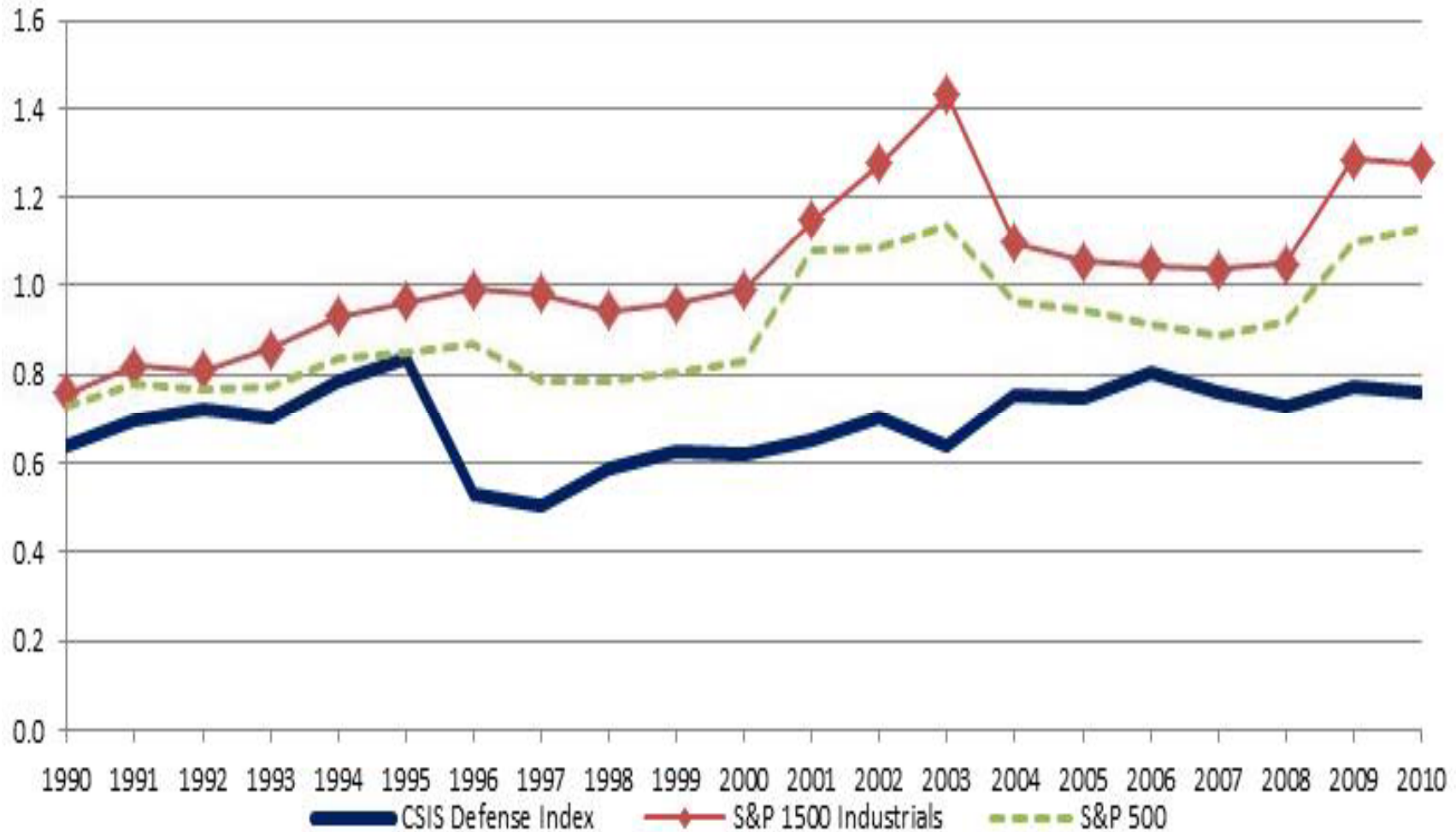
CSIS Defense, S&P 500, and S&P 1500 Industrials, (1990-2010)



Source: Bloomberg, analysis by CSIS Defense-Industrial Initiatives Group.

Quick Ratio Comparison

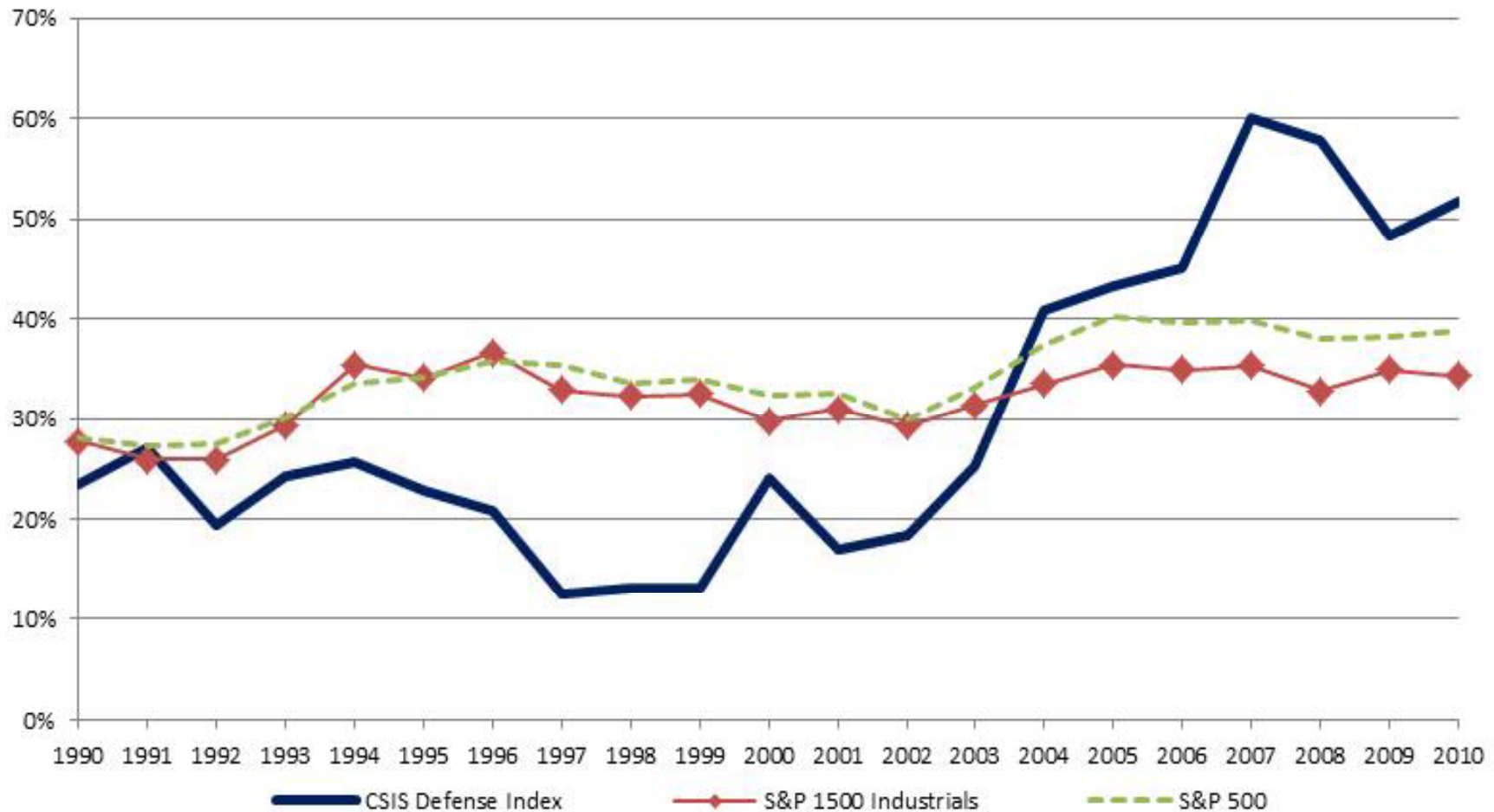
CSIS Defense, S&P 500, and S&P 1500 Industrials, (1990-2010)



Source: Bloomberg, analysis by CSIS Defense-Industrial Initiatives Group.

Coverage Ratio Comparison

CSIS Defense, S&P 500, and S&P 1500 Industrials, (1990-2010)



Source: Bloomberg, analysis by CSIS Defense-Industrial Initiatives Group.

Market Relative Valuation:

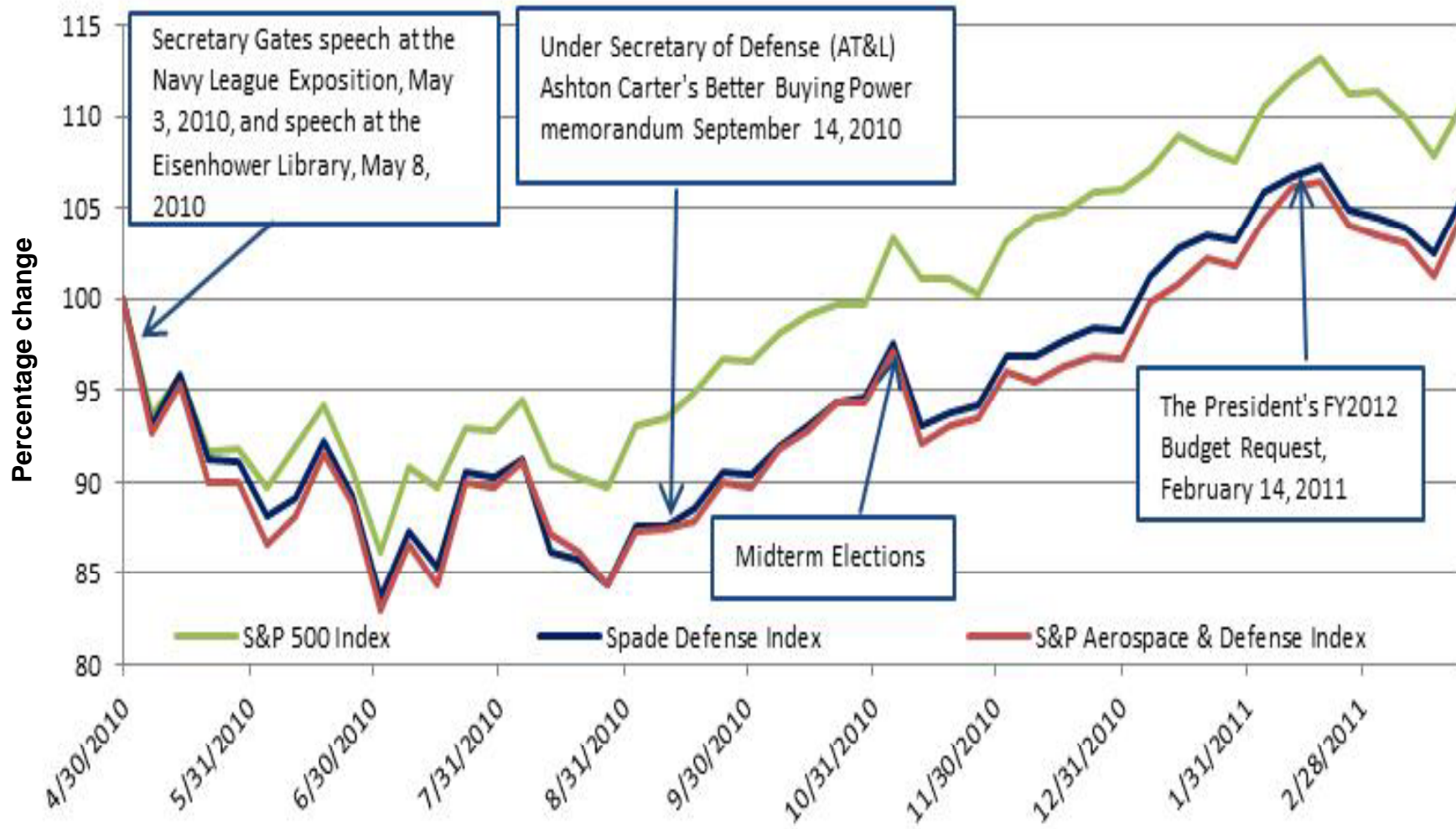
- **Index Price Performance**
 - Percentage Change in Share Price
- **Price Earning Ratio**
 - Price per Share / Earnings per Share
- **EV / EBITDA**
 - Market Capitalization + Preferred Equity + Minority Interest
– Total Debt – Cash & Equivalent / Earning Before Interest,
Taxes, Depreciation & Amortization (EBITDA)

Index Performance, Percentage Change in Share Price 1999-2011 (1999=100)



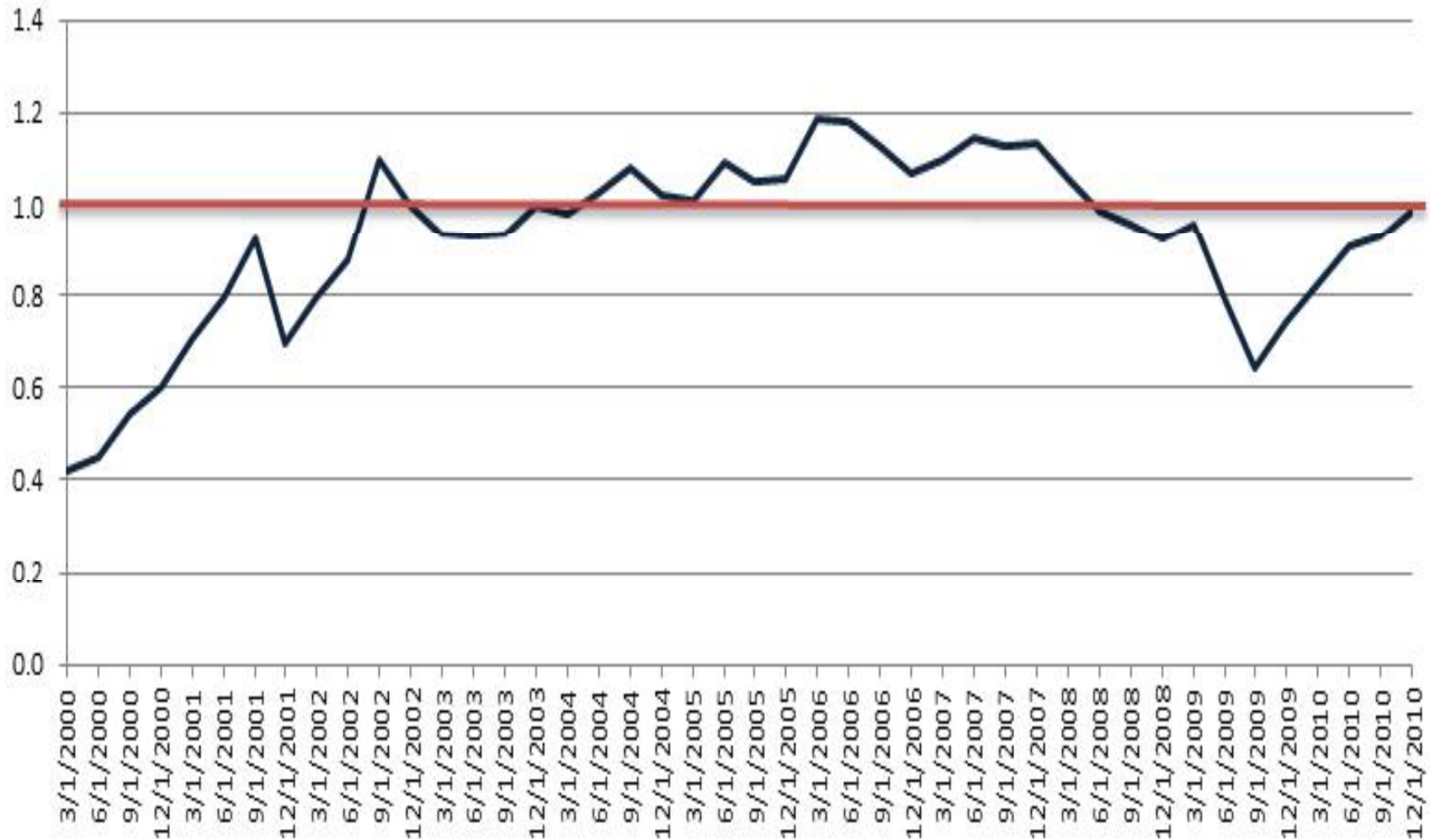
Source: Bloomberg, analysis by CSIS Defense-Industrial Initiatives Group.

Index Performance, Percentage Change in Share Price 4/10-4/11 (April 30, 2010=100)



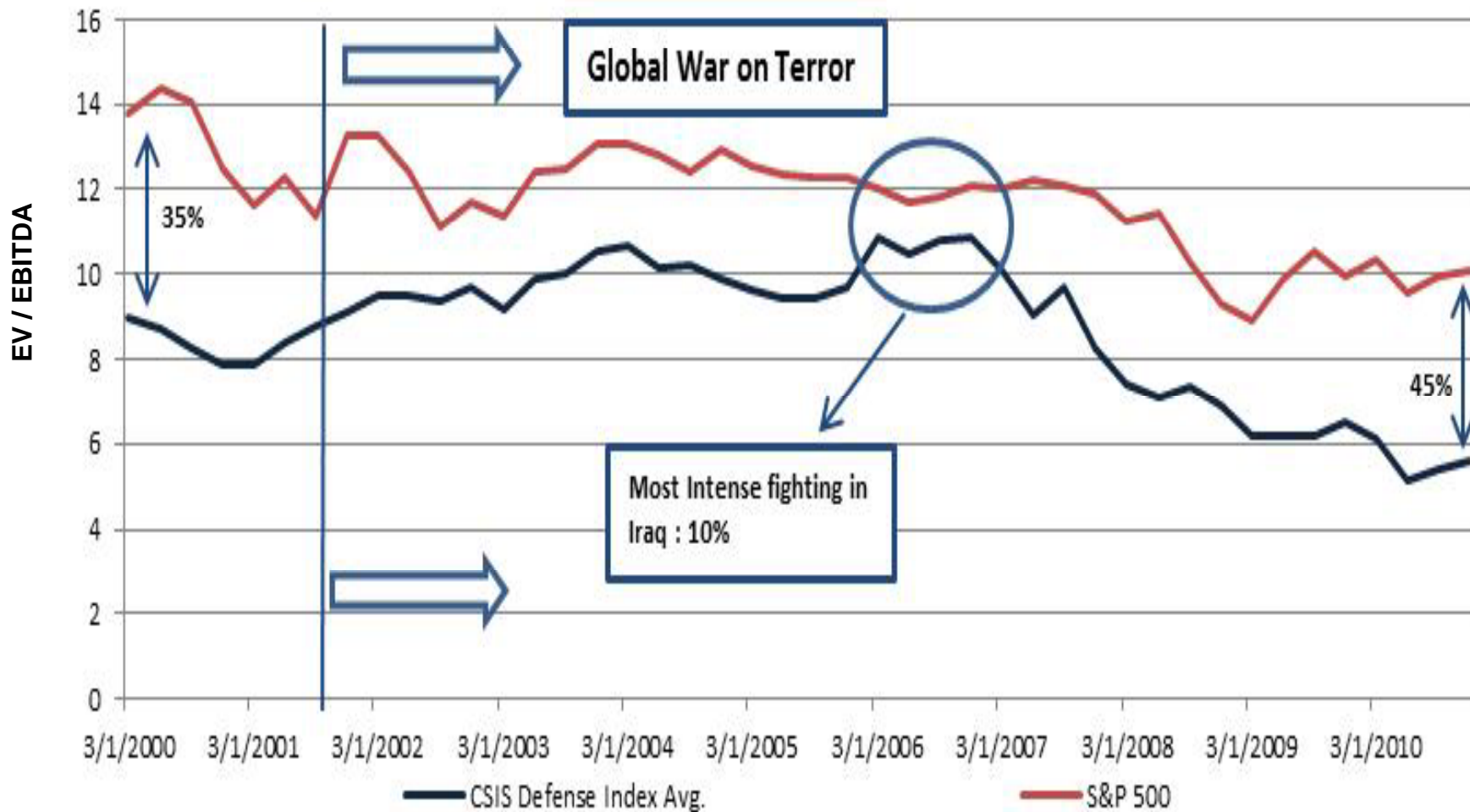
Source: Bloomberg, analysis by CSIS Defense-Industrial Initiatives Group.

CSIS Defense Index P/E Ratio Relative to the S&P 500



Source: Bloomberg, analysis by CSIS Defense-Industrial Initiatives Group.

EV/EBITDA Comparison: CSIS Defense and S&P 500 Indices



Source: Bloomberg, analysis by CSIS Defense-Industrial Initiatives Group.

Summary & Conclusions:

Key takeaways:

1. Defense firms' balance sheets are stronger today than at any point in the past 20-years.
2. The industry enjoys record profit margin and cash flow.
3. Liquidity ratios lower than peers but suggest efficient capital deployment.
4. Investors are discounting the industry in anticipation of shrinking budgets and unfavorable business environment (squeeze on profitability).
5. It is unlikely that access to capital markets will change significantly for prime and sub-prime defense contractors.
6. The effect of the downturn in defense spending on small and medium defense firms access to capital markets is less clear.

Continue...

Issues for policymakers:

1. How can DoD keep the defense industrial base vital in a time of flat / declining investment?
2. Does DoD have the tools to guide the defense-industrial base to where DoD thinks it should be?
3. Can companies preserve margins when their main customer is fiscally constrained?
4. Can defense firms maintain healthy balance sheets at time of declining defense budgets?

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