

27 February 2014

The Wall Street Perspective...

**... and how M&A and Antitrust Issues Will Shape the
Post-Downcycle US Munitions Industrial Base**

Presented to: NDIA Munitions Executive Summit
 Morristown, NJ



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Disclaimer: I will contradict myself in this talk...

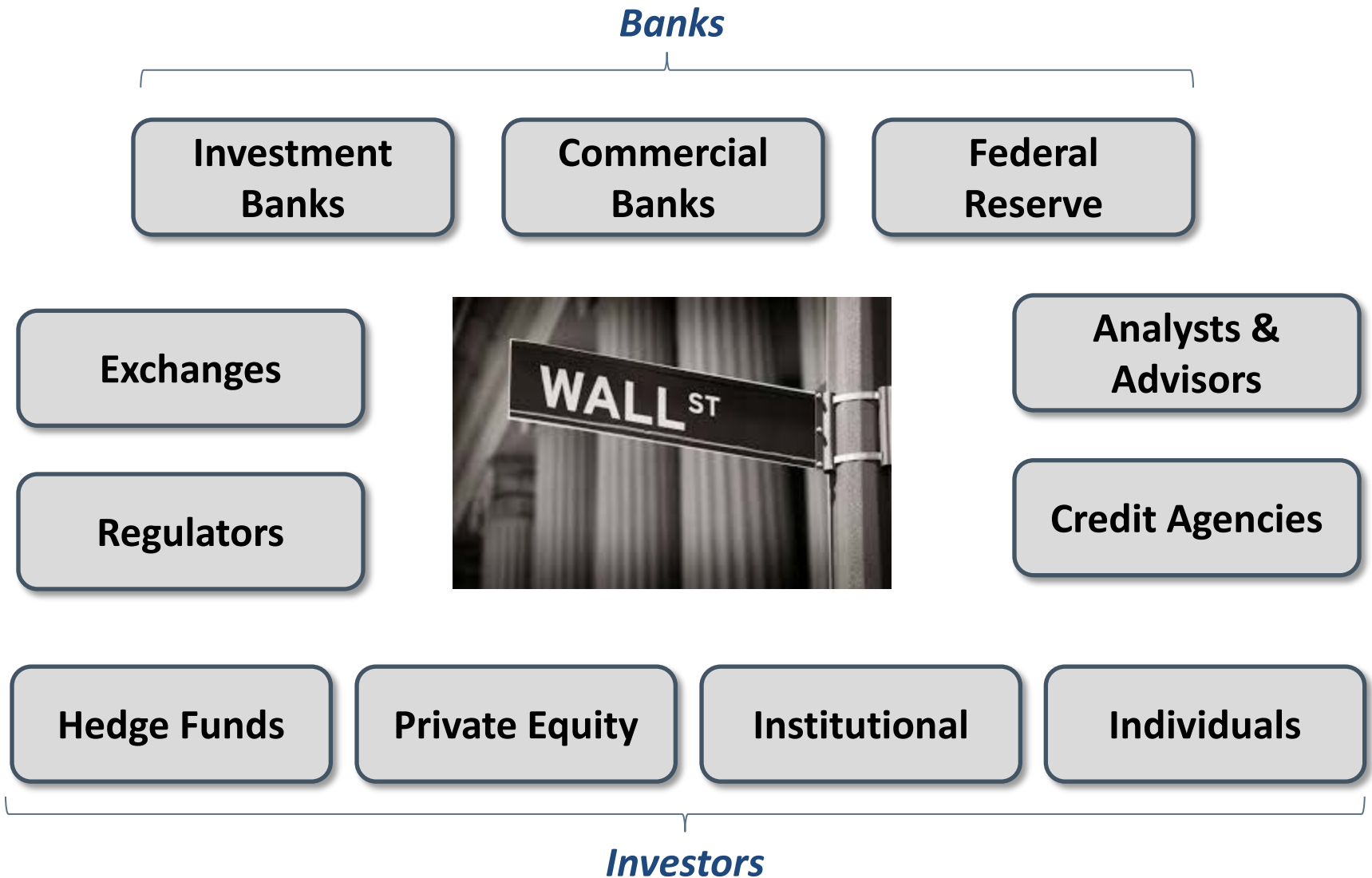
“On the one hand...”



“On the other...”



... because many of the behaviors I'll discuss seem irrational

What is “Wall Street”?

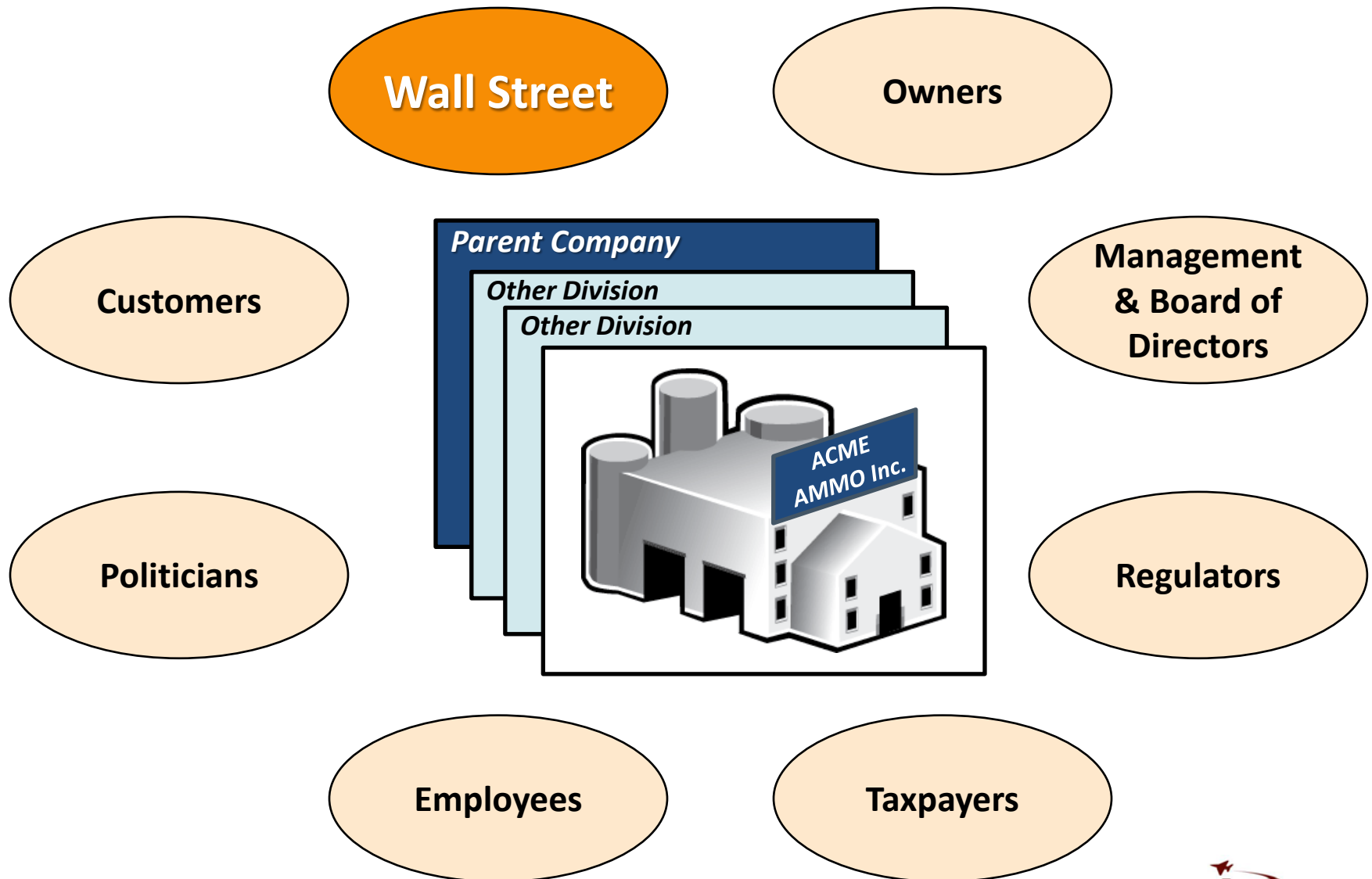


Why do I care?

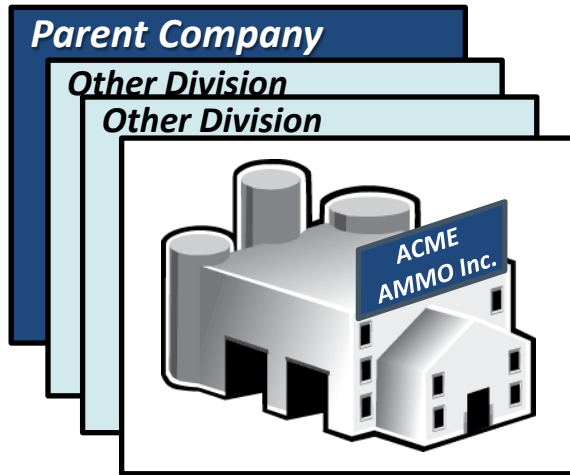
- **Direct impacts on contractors:**
 - Provides capital (e.g., working capital loans, equity, senior debt, bonds, etc.)
 - Creates incentives and reward system (e.g., part of comp package, pension)
 - Sets price of capital (e.g., share price, interest rate, covenants, etc.)
 - Shapes perception of value (e.g., buy/sell recommendations, ratings agencies)
 - Change agent (e.g., mechanism for owner exit/entry, activist shareholders, etc.)

- **Indirect impacts on contractors:**
 - Influences size of DoD budget (e.g., interest rates  on USG debt, DoD \$\$ )
 - Creates context to compare attractiveness of defense sector against others
 - Creates a “rule set” that drives accountability among buyers and sellers
 - Many others....

It is a Core Stakeholder in the Defense Industry ...



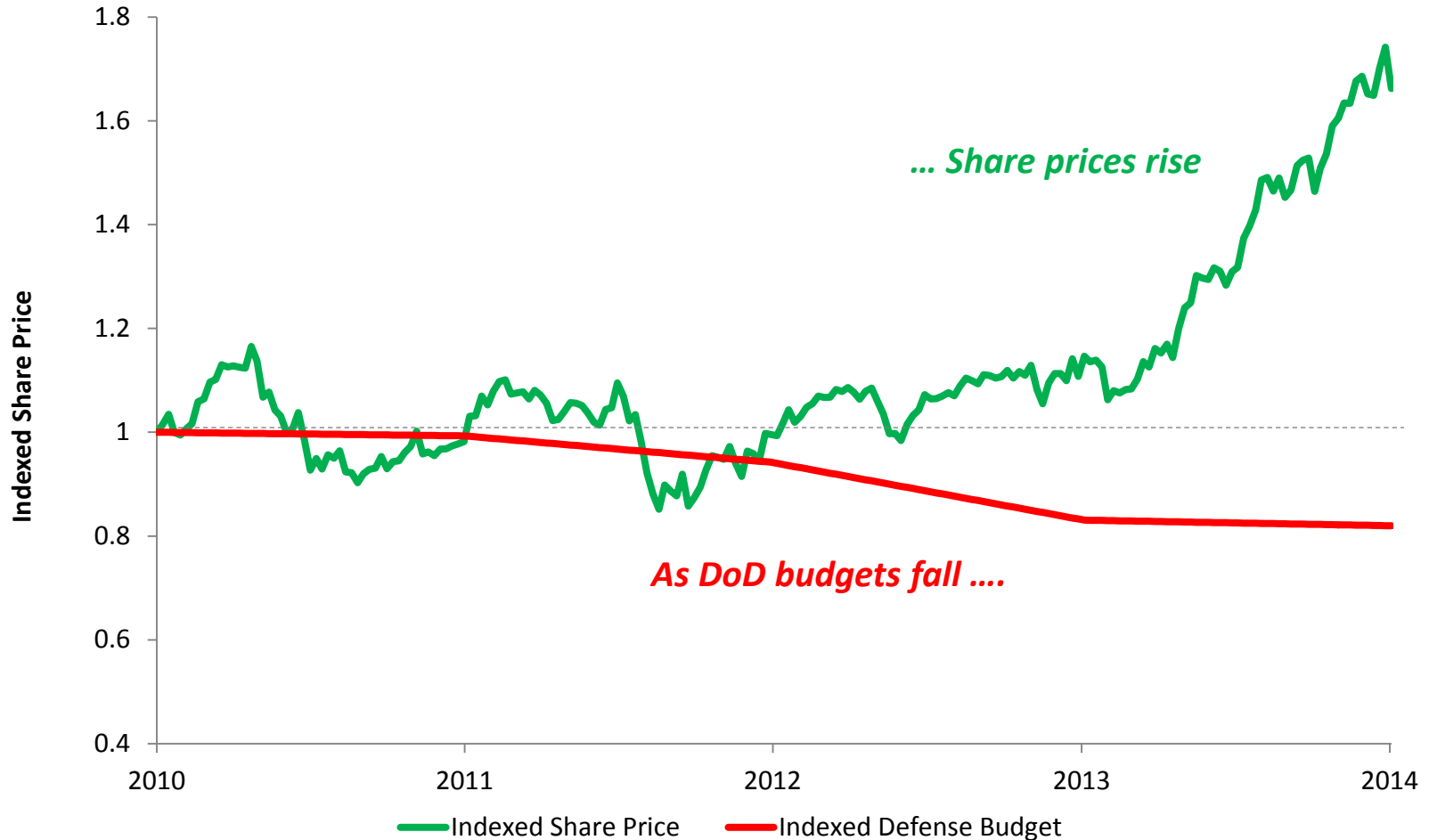
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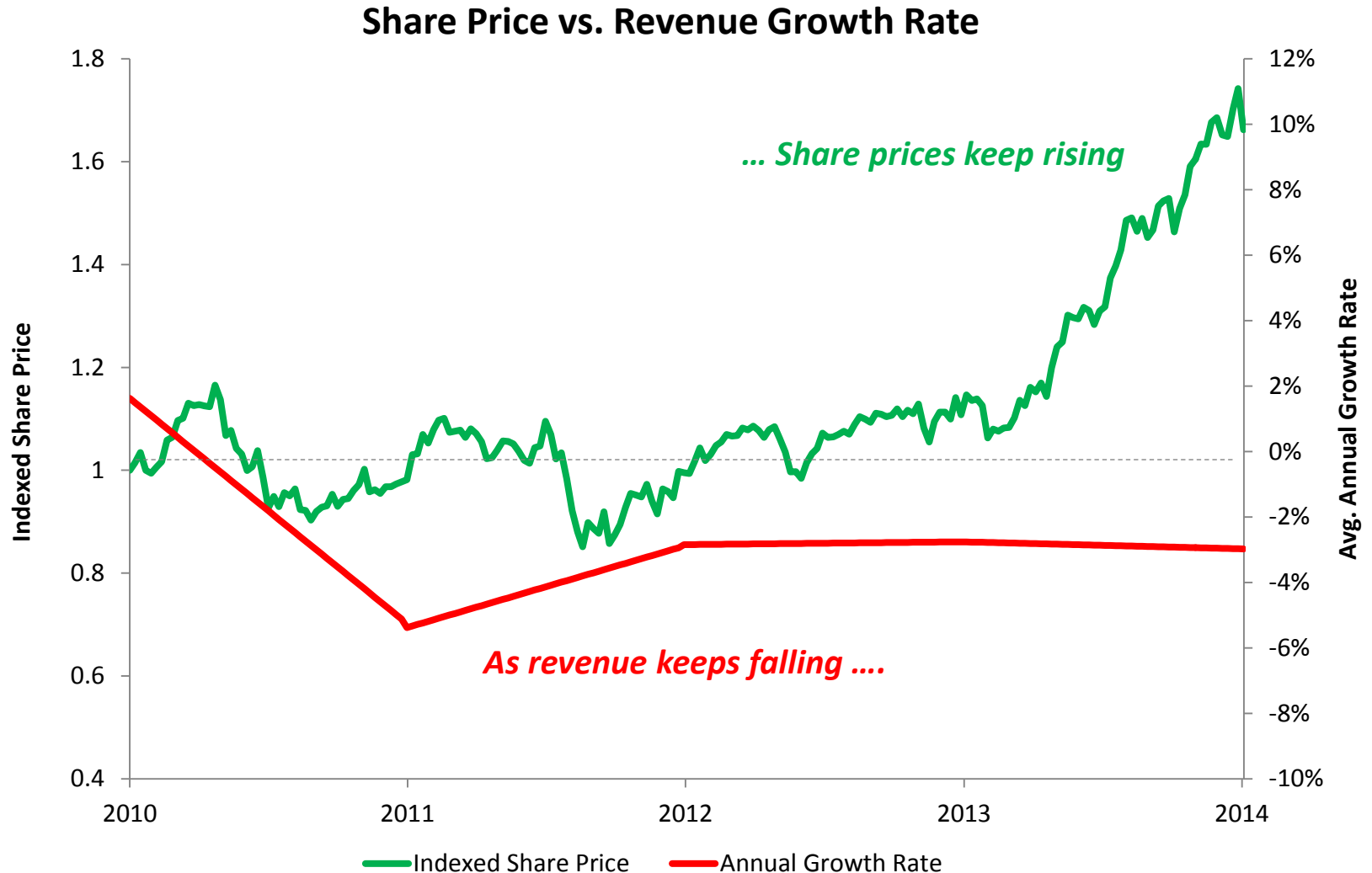
Wall Street Appears to Ignore DoD Budget Trends....



Notes: Includes GD, LMT, NOC, RTN, LLL

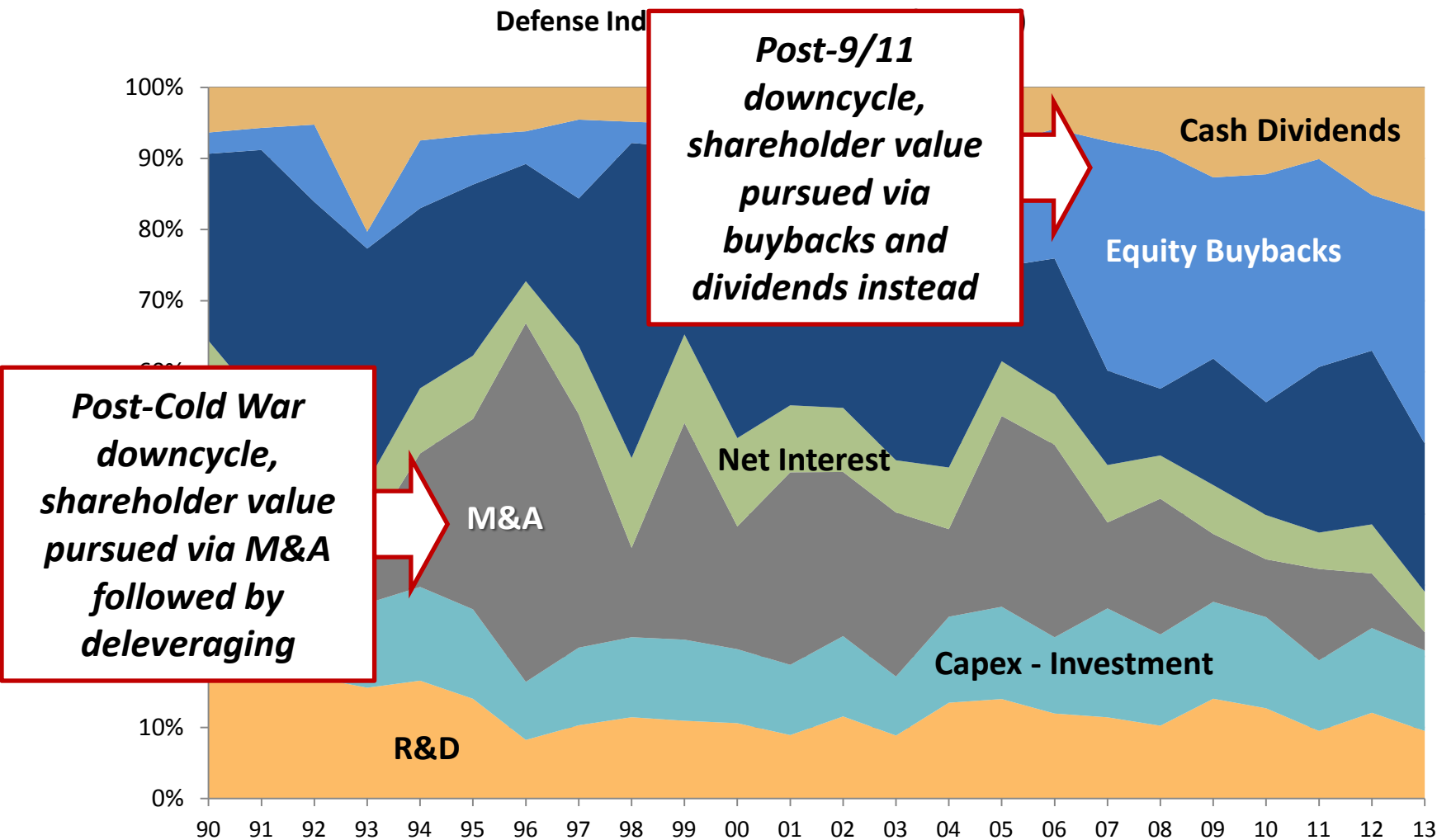
Sources: FactSet, RSAdvisors analysis

... and Revenue Trends...



Notes: Includes GD, LMT, NOC, RTN, LLL
Sources: FactSet, RSAdvisors analysis

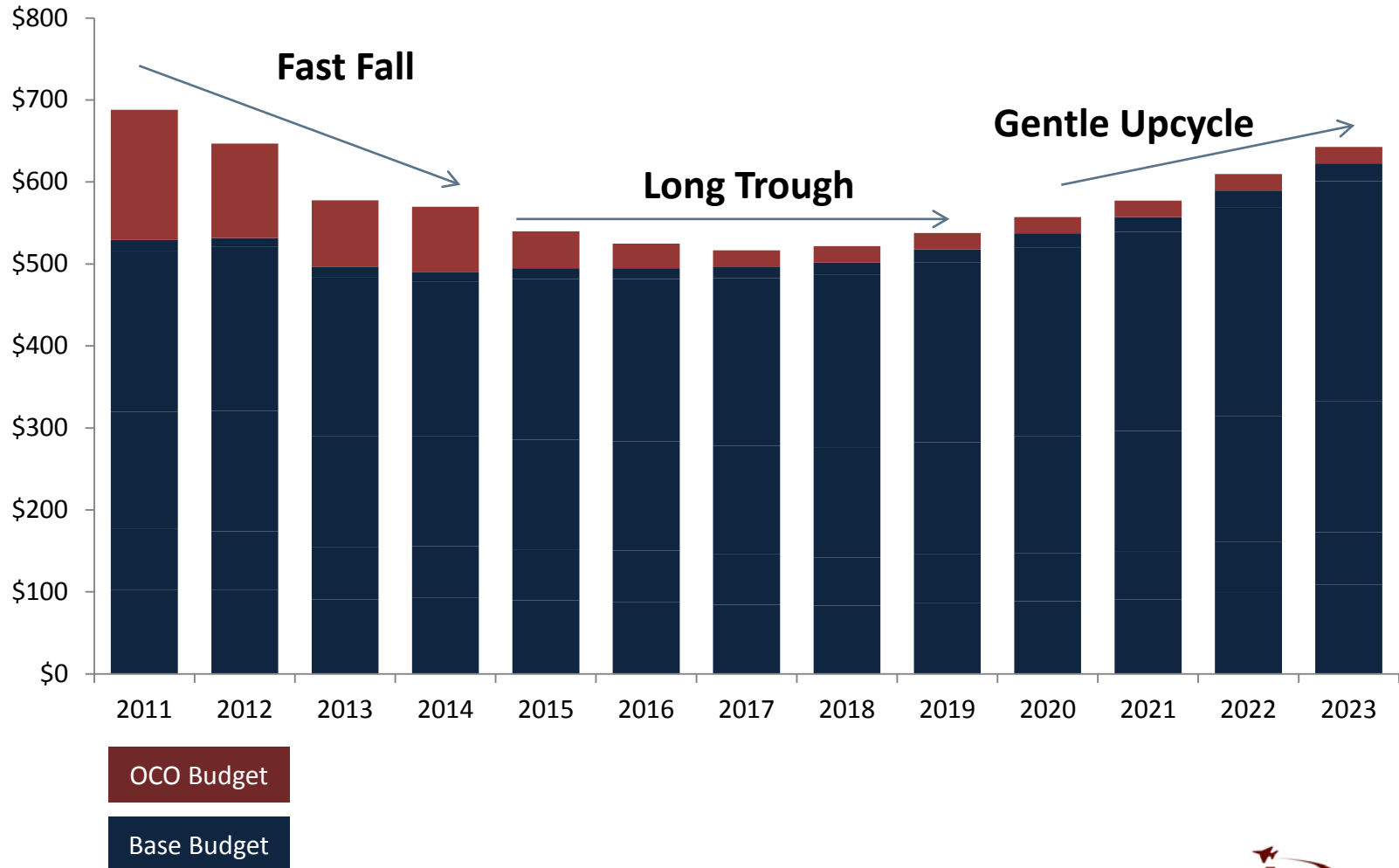
...but it clearly doesn't ignore cash, hence stocks go up



Source: FactSet, S&P Compustat, Energy Information Administration, National Defense Budget Estimates, CapitalIQ, Company filings, RSAdvisors analysis

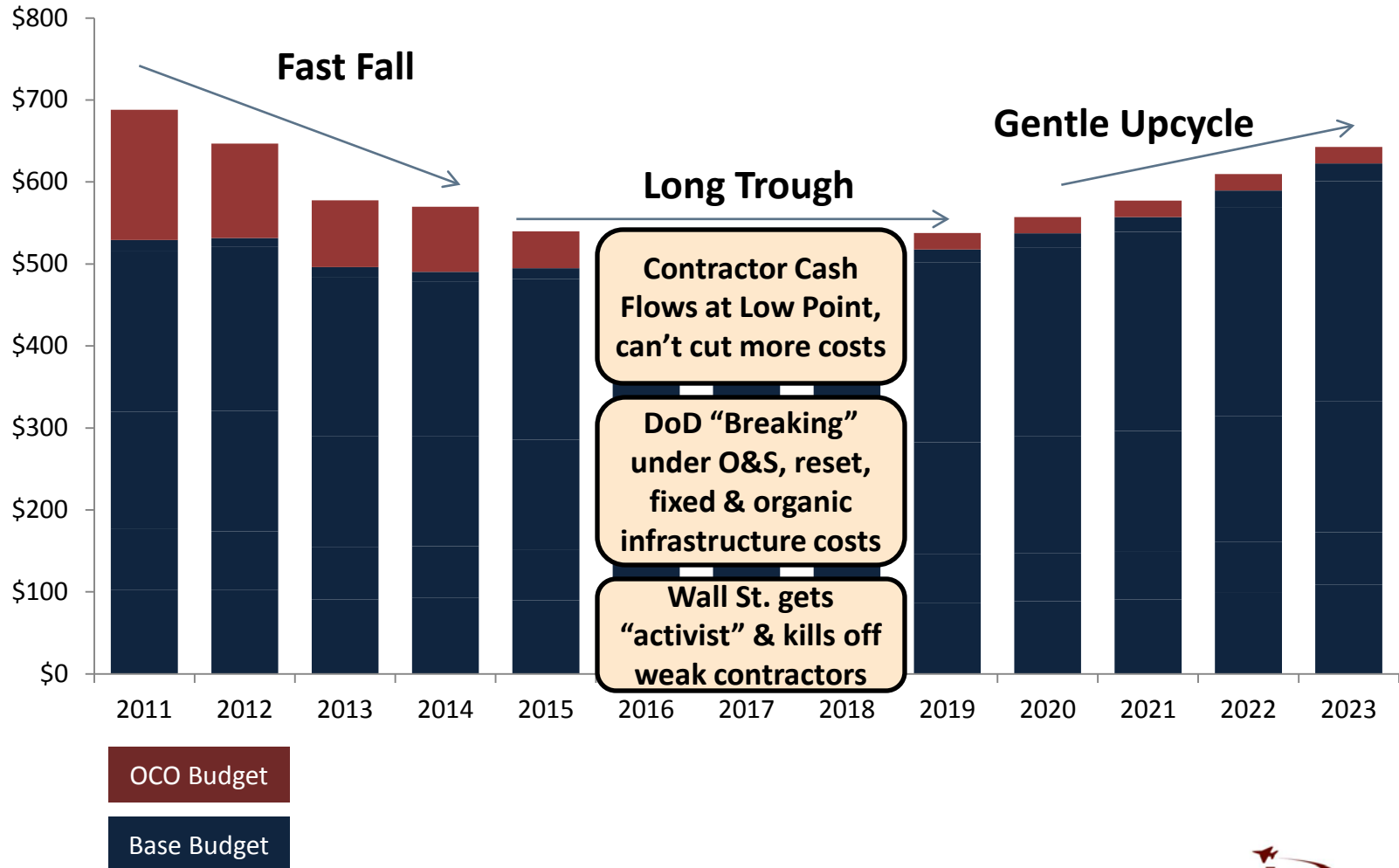
So What Does This Mean in the Current Context?

Highly Plausible Scenario for DoD Total Budget Authority (current \$B)



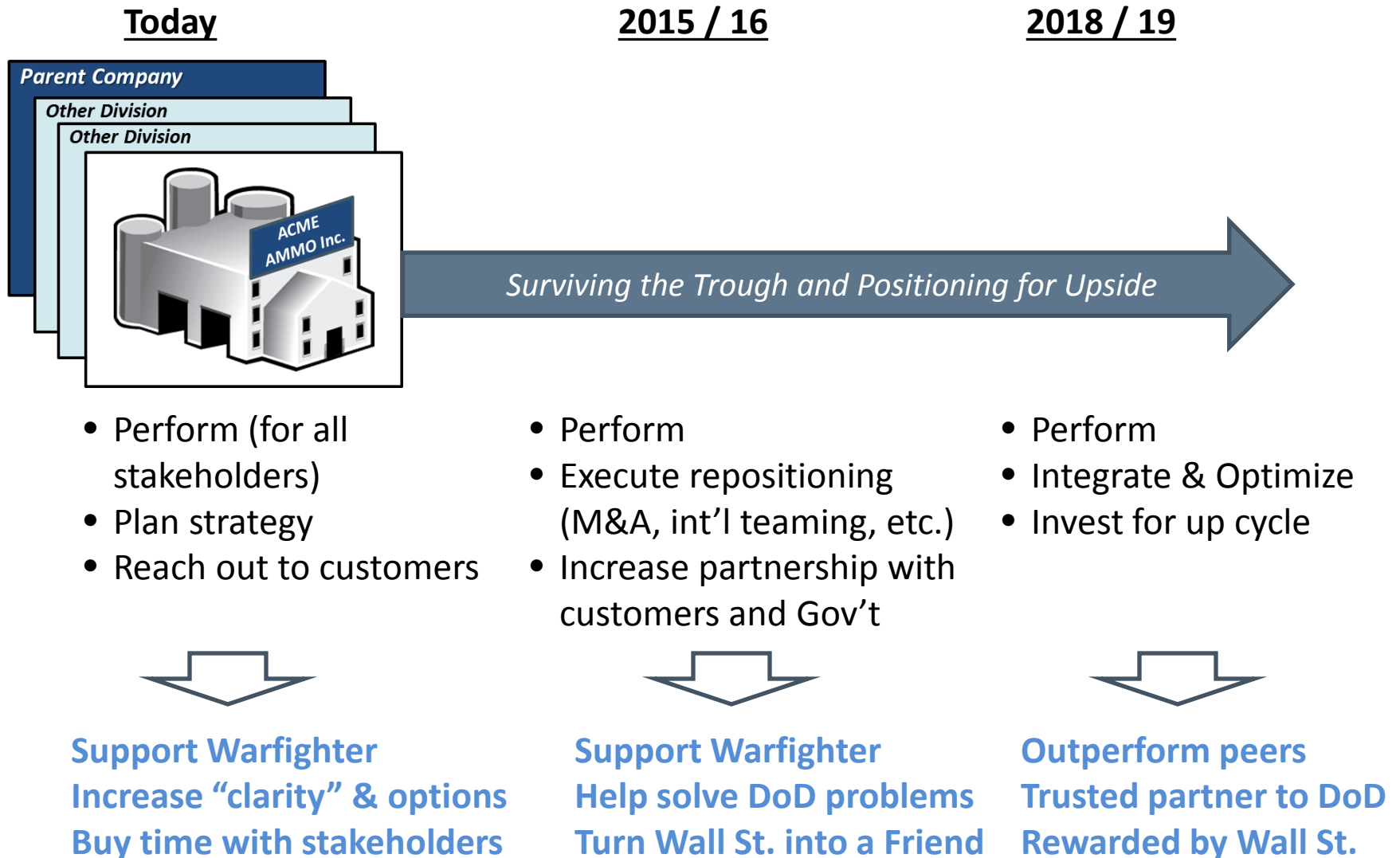
So What Does This Mean in the Current Context?

Highly Plausible Scenario for DoD Total Budget Authority (current \$B)



Sources: DoD budget materials, OMB, CSBA, Capital Alpha, RSAdvisors analysis

So What Should a Contractor Do?



Perspective on Consolidation and Antitrust

- **The munitions sector will need to address this and soon**
- **The DoD knows this and is prepared to work with you, just reach out**
 - Private company rationalization
 - Organic industrial base rationalization
- **DoD is only part of the regulatory team, and DoJ / FTC act very differently**
- **Key things to remember as you repositioning via M&A:**
 - It is all about market segment definition and who is deemed “competitive”
 - Personalities matter, and when people change, so do policies and practices
 - There is a first mover advantage when sectors start to consolidate
 - You will not be rewarded by being deferential to the Government
 - Communicate early, often and with everyone
 - It is actually hard for the Government to say “no”
 - But the ride does stop, just ask Lockheed Martin and Northrop Grumman

A Few Parting Thoughts

- **The munitions sector is critical and capabilities must be sustained**
- **Wall St. is a wacky and often confusing stakeholder, but it is a rational actor**
- **Risk ultimately is shared by contractors and the government**
 - Yes, more being pushed onto contractors, but the warfighter bears the most risk
 - Also, DoD policies reduce financial risk compared to purely commercial markets
- **Perform and communicate and you will be just fine**
- **Always be bold in your thinking and try to solve the big problems**
- **Good management is essential, but we need leaders to get us through this**