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
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”?

**Banks**

- Investment Banks
- Commercial Banks
- Federal Reserve

**Exchanges**

**Regulators**

**Hedge Funds**

**Private Equity**

**Institutional**

**Individuals**

**Analysts & Advisors**

**Credit Agencies**

**Investors**
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 ...
... that ultimately it doesn’t care about the sector
... that ultimately it doesn’t care about the sector

Wall Street Cares about Money!!!!
Wall Street Appears to Ignore DoD Budget Trends....

As DoD budgets fall ....

... Share prices rise

Indexed Share Price
Indexed Defense Budget

Notes: Includes GD, LMT, NOC, RTN, LLL
Sources: FactSet, RSAadvisors analysis
... and Revenue Trends...

![Graph showing Indexed Share Price and Annual Growth Rate over time]

- Share prices keep rising
- As revenue keeps falling ....

Notes: Includes GD, LMT, NOC, RTN, LLL
Sources: FactSet, RSAdvisors analysis
...but it clearly doesn’t ignore cash, hence stocks go up

Post-9/11 downcycle, shareholder value pursued via buybacks and dividends instead

Post-Cold War downcycle, shareholder value pursued via M&A followed by deleveraging

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)

Source: DoD budget materials, OMB, CSBA, Capital Alpha, RSAdvisors analysis
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?

**Today**
- Perform (for all stakeholders)
- Plan strategy
- Reach out to customers

**Support Warfighter**
- Increase “clarity” & options
- Buy time with stakeholders

**2015 / 16**
- Perform
- Execute repositioning (M&A, int’l teaming, etc.)
- Increase partnership with customers and Gov’t

**Support Warfighter**
- Help solve DoD problems
- Turn Wall St. into a Friend

**2018 / 19**
- Perform
- Integrate & Optimize
- Invest for up cycle

**Outperform peers**
- Trusted partner to DoD
- Rewarded by Wall St.
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