

Not for Further Distribution

# Wall Street and the Pentagon

An Annotated Brief:

## The Defense Budget and Defense Industry Finance

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May 12, 2010

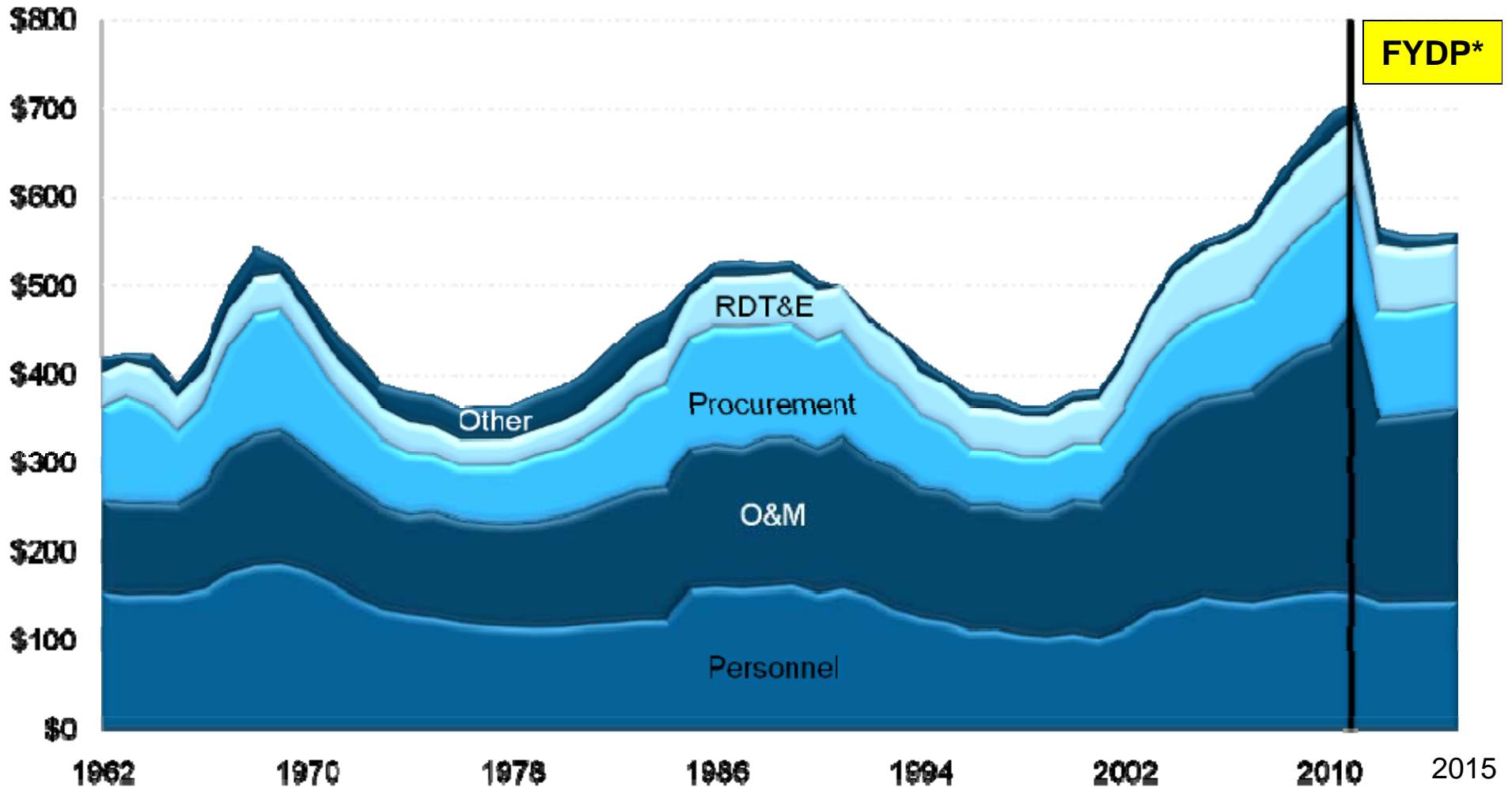
CSIS

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Defense-Industrial  
Initiatives Group

# Department of Defense (DoD) Outlays, 1962-2011

(Constant FY2010 US\$ bn)



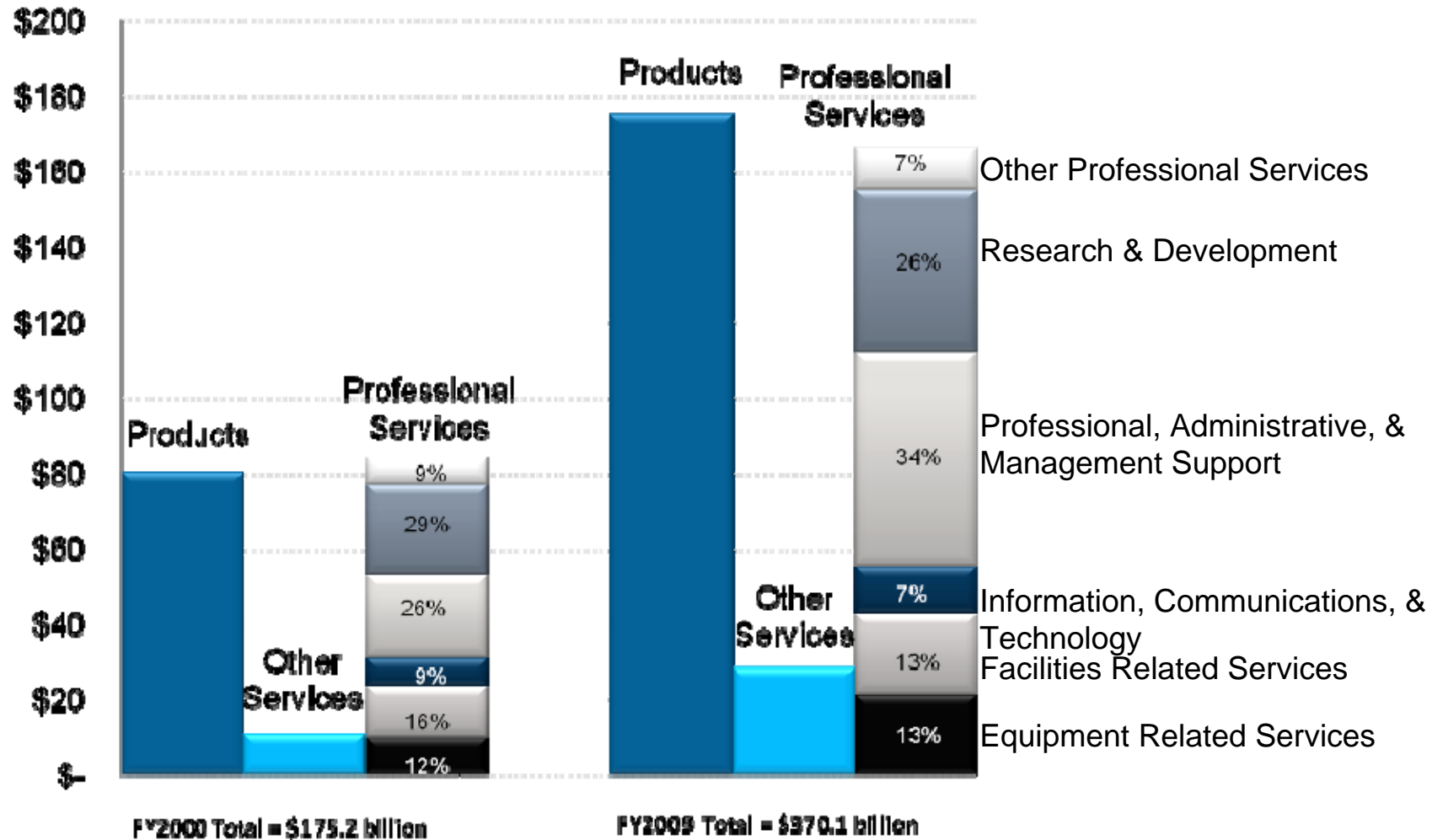
FY1962-FY2009 = Historical Outlays; FY2010 = Budget Authority including OCO as of February 2011; FY2011 = Budget Request Including OCO

Source: DoD Comptroller; analysis by CSIS Defense-Industrial Initiatives Group

\* Excluding OCO

# Composition of Total DoD Contracts

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



Source: Federal Procurement Data System, analysis by CSIS Defense-Industrial Initiatives Group

## 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

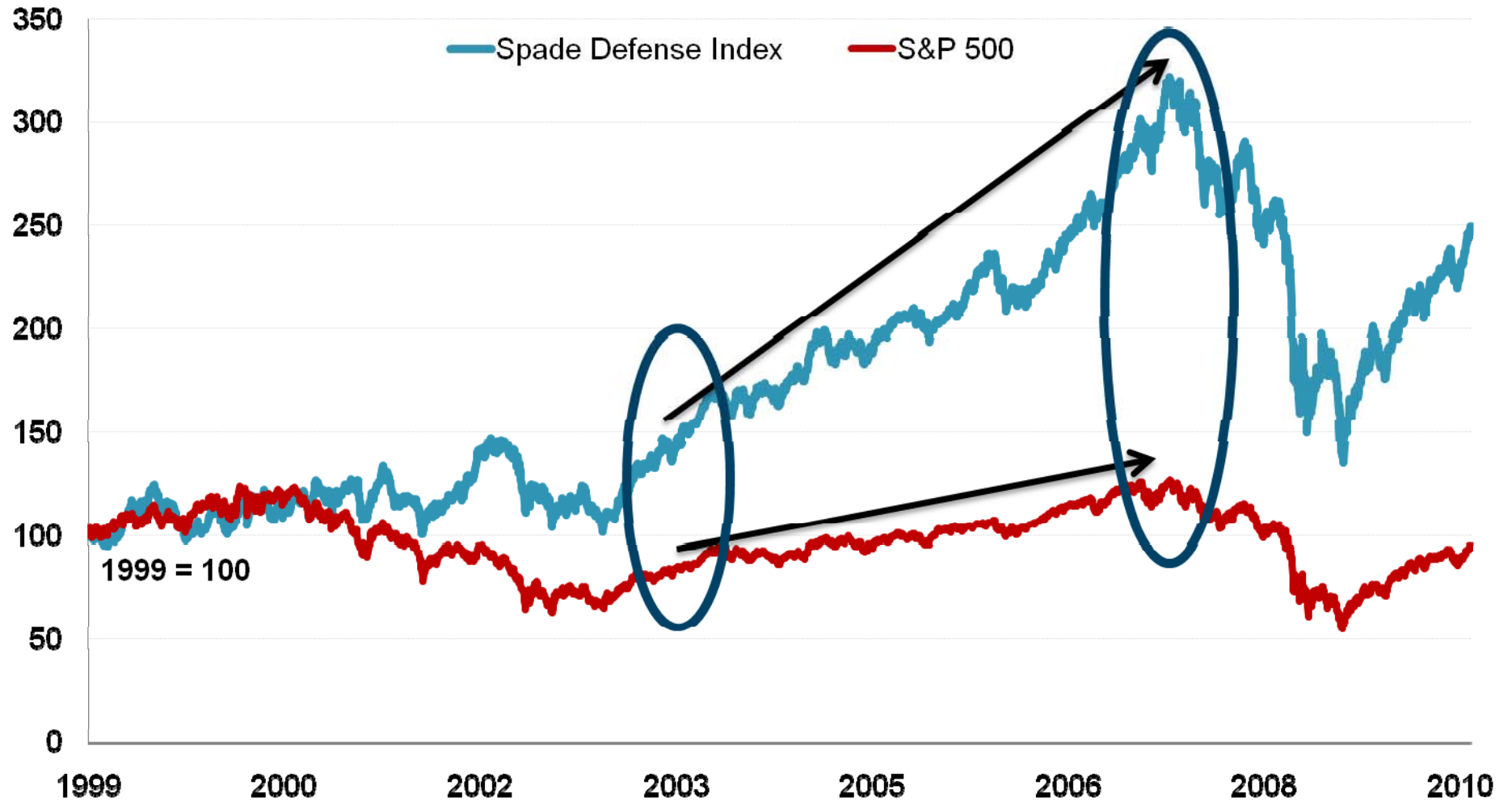
- **Companies added as data becomes available**

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**

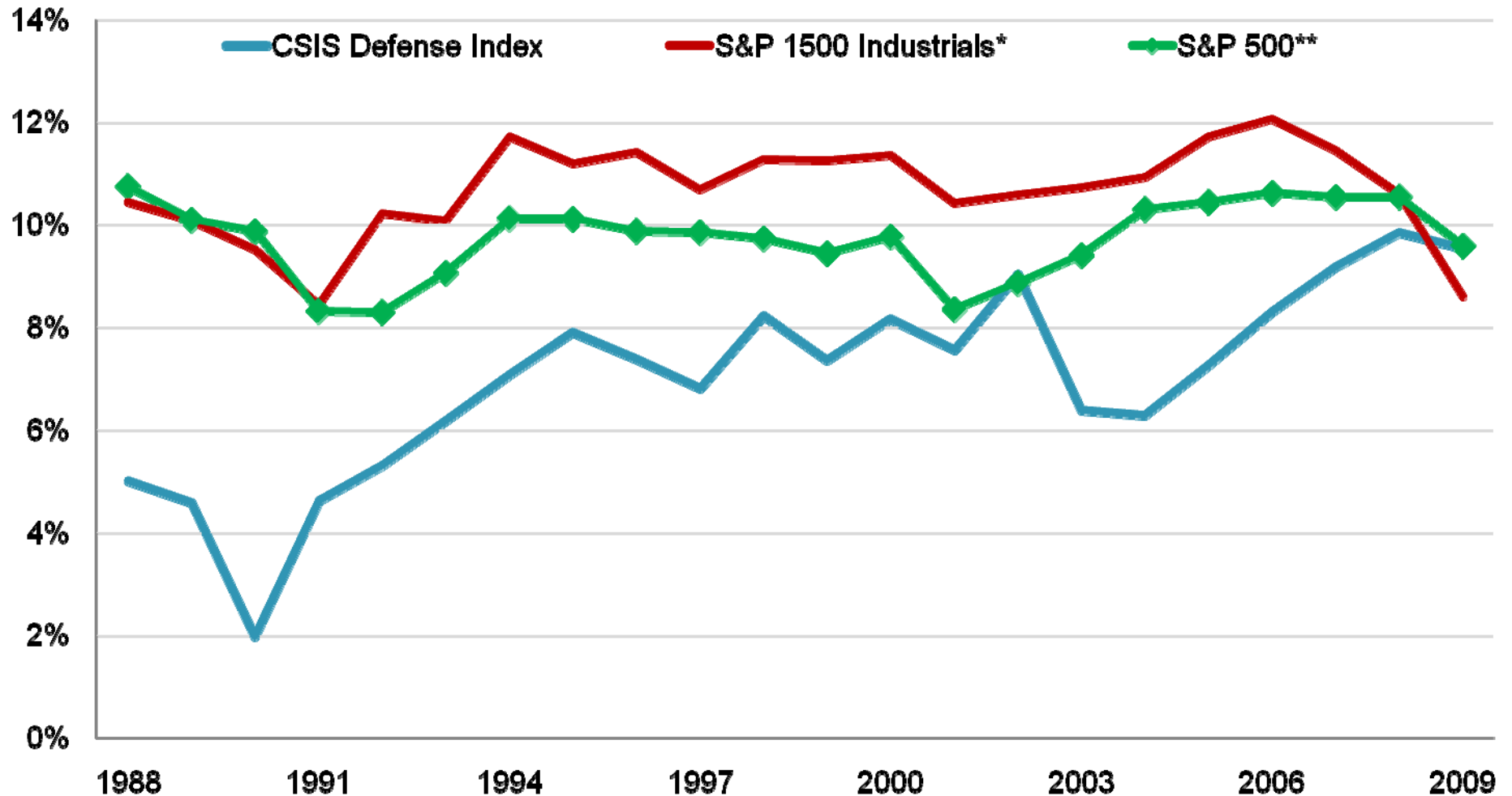
# On Wall Street: Outperformance from 2003 to 2007

Index Performance, 1999-2010



# CSIS Defense Index Operating Margin are at a High

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

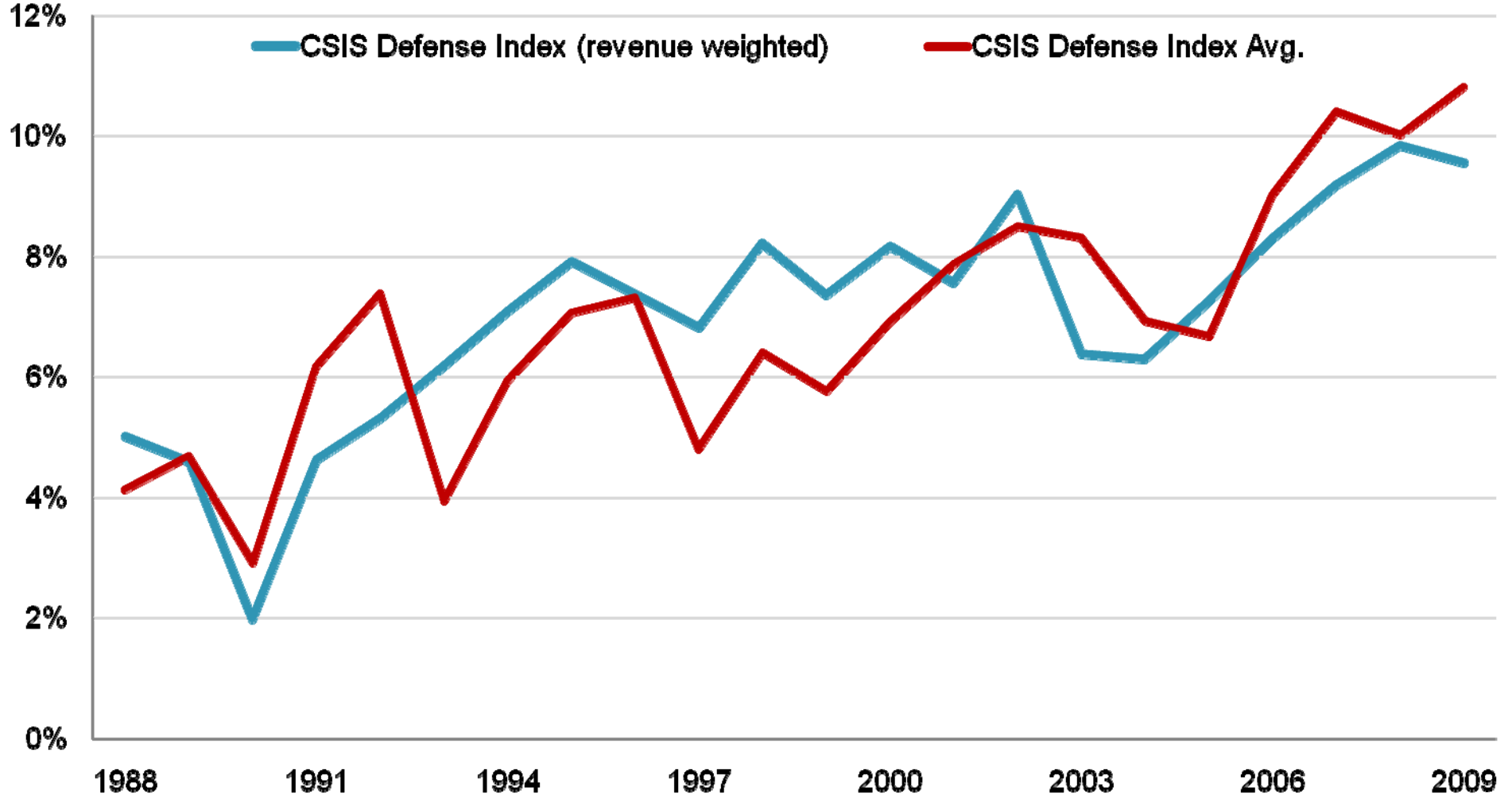


\*Excluding Defense \*\* Excluding Defense & Financials

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

# Performance Vary according to Size (by Revenue)

Operating Margin, 1988-2009

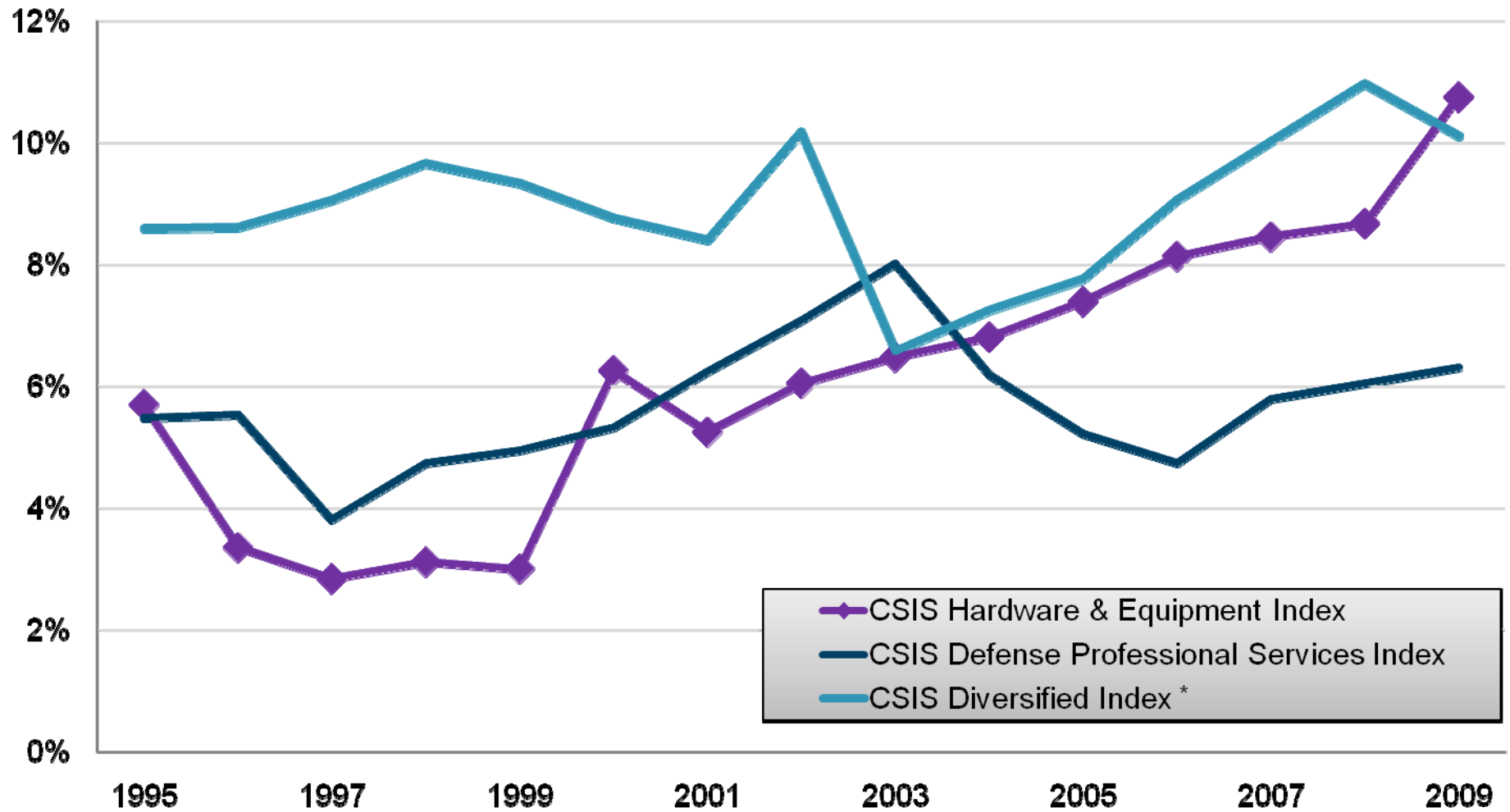


Excluding extreme points

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

# CSIS Index Performance Vary by Business Segment

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



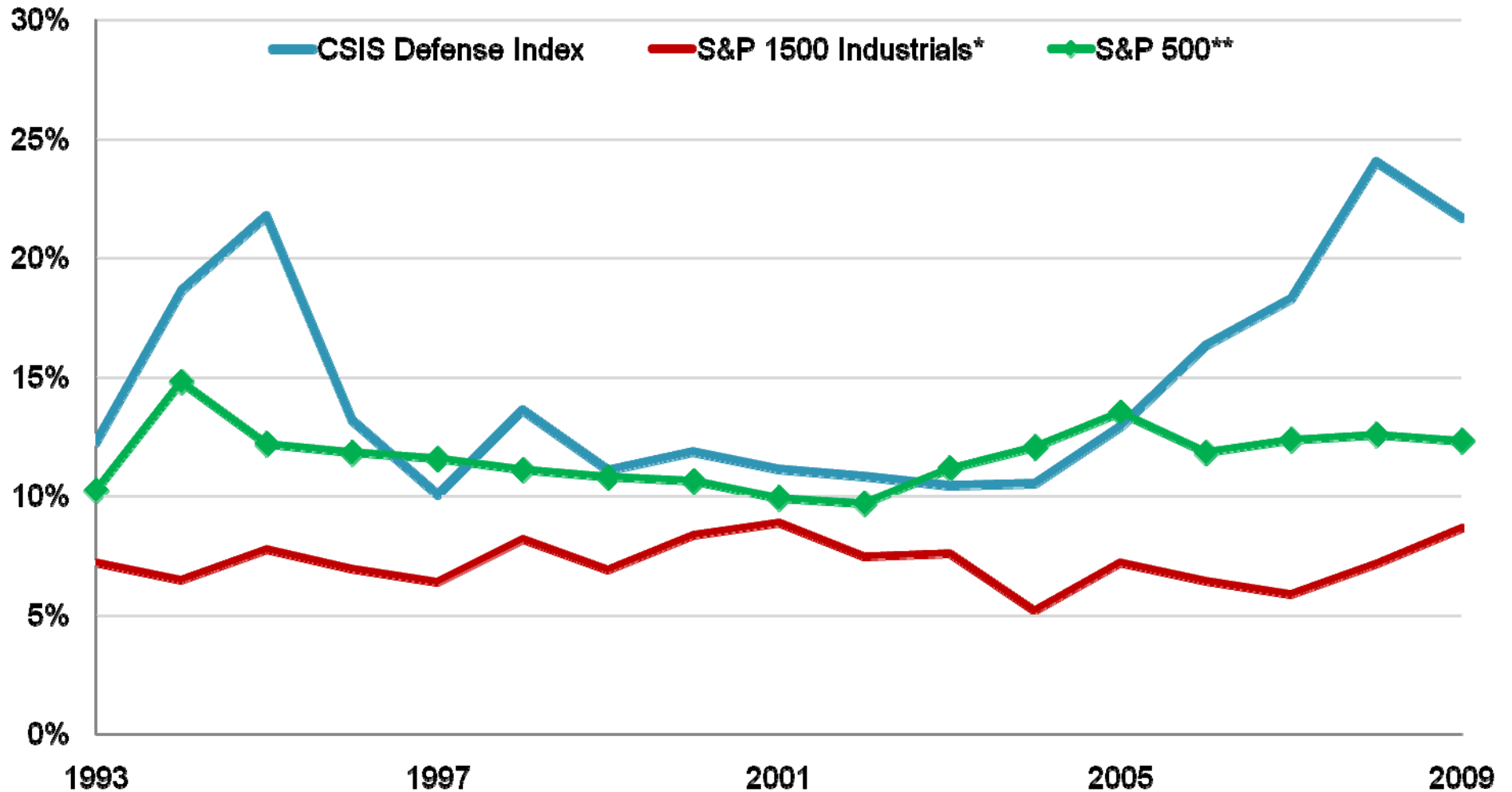
\* Companies operating in both the defense professional services and hardware & equipment spheres

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)

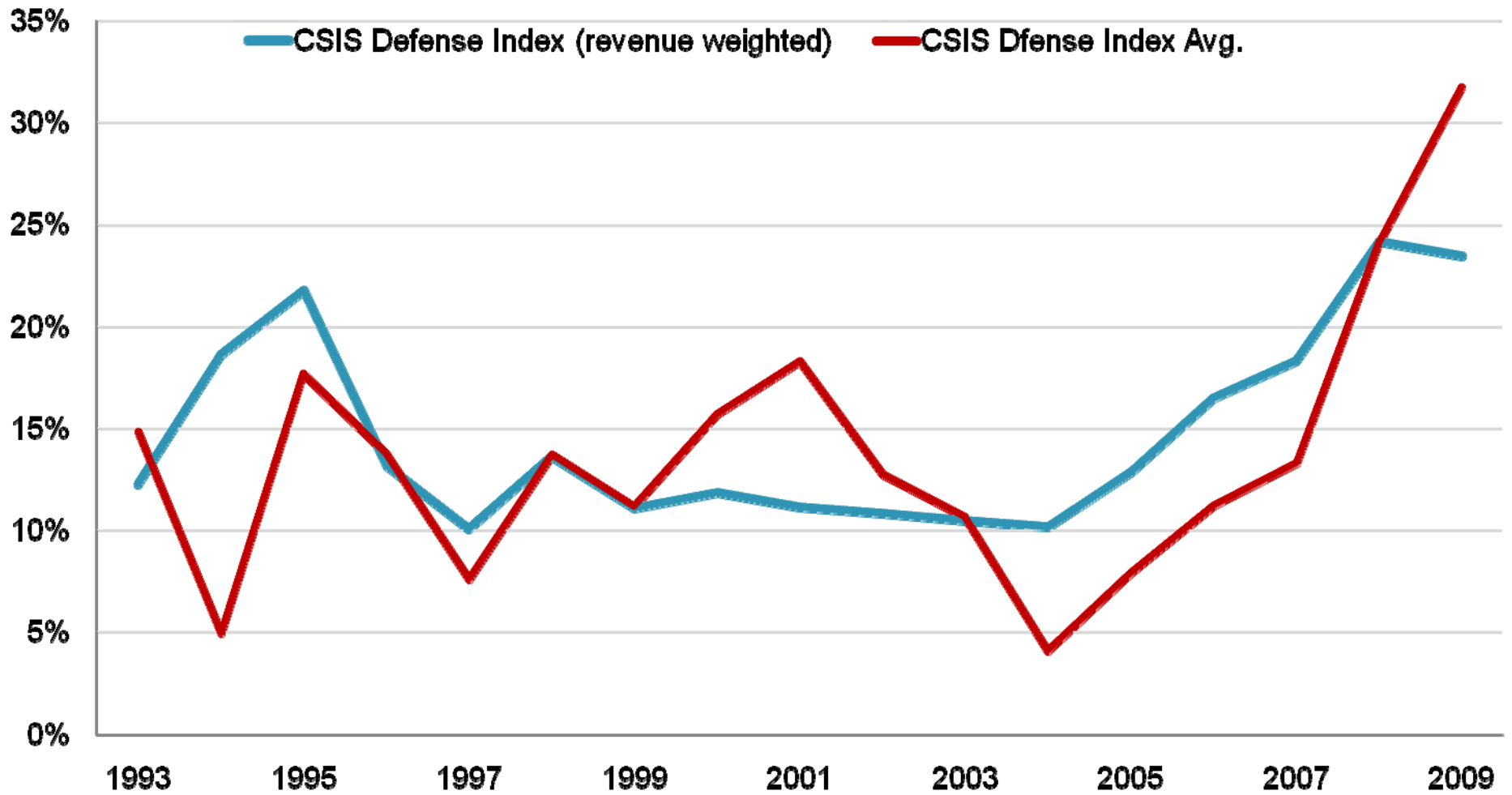


\*Excluding Defense \*\* Excluding Defense & Financials

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

# CSIS Defense Index CFROI Vary by Size

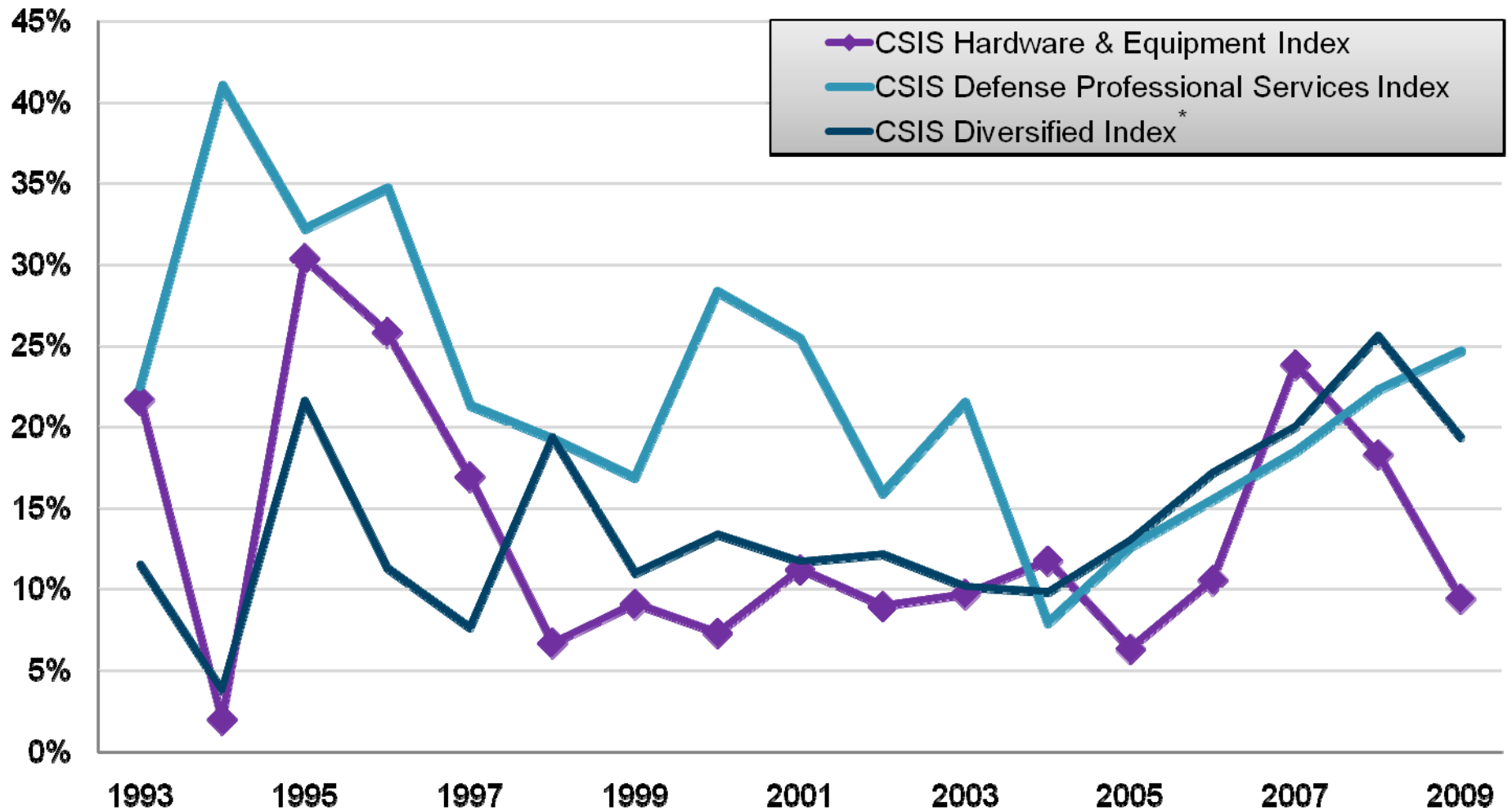
Cash Flow Return on Investment (CFROI), 1993-2009



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

# 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

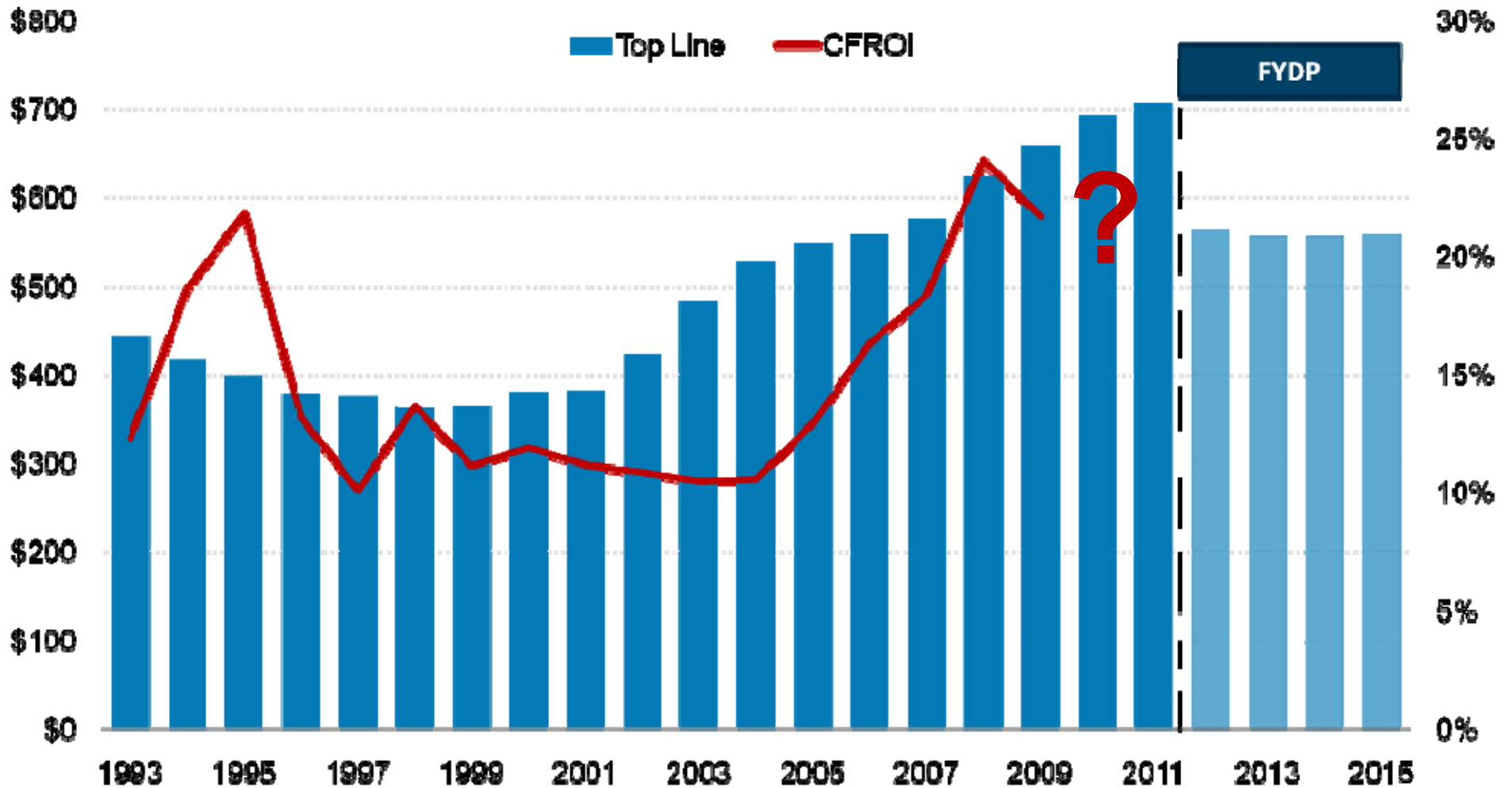
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## Key Questions

1. How can companies position for an era of flat / declining investment?
2. 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)



Sources: DoD Comptroller, Bloomberg, analysis by CSIS Defense-Industrial Initiatives Group

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## About CSIS

At a time of new global opportunities and challenges, the Center for Strategic and International Studies (CSIS) provides strategic insights and policy solutions to decisionmakers in government, international institutions, the private sector, and civil society. A bipartisan, nonprofit organization headquartered in Washington, DC, CSIS conducts research and analysis and develops policy initiatives that look into the future and anticipate change.

Founded by David M. Abshire and Admiral Arleigh Burke at the height of the Cold War, CSIS was dedicated to finding ways for America to sustain its prominence and prosperity as a force for good in the world.

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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