

## Equities

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# Keeping Things Fresh

## Investment pays more today but that doesn't mean its going away

### ■ Industry Overview

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- **We're Still Constructive on Defense** – Going into the budget release Monday morning, we already knew what the top-level numbers would be thanks to recent headlines & late January's budget preview: \$525b base budget (down 1% y/y), \$168b base investment account (down 4% y/y) & \$89b supplemental (down 23% y/y). The 5Y savings are \$260b (vs. the 10Y target of \$490b). However, today's release clarified that DoD will generate an increasing share of savings from the non-investment accounts (O&M, Milpers, Construction). While investment accounts contribute 54% of savings in FY13, they'll contribute 44% over the FYDP (FY13-17). This is in line with our view that the low-hanging fruit resides outside the investment accounts.
- **The FYDP Mix** – The top-line FYDP saves \$260b over 5Y. 44% comes from investment accounts, 23% from O&M, 27% from Milpers, and 7% from construction.
- **The Modernization Mix** – Procurement (P) generally carries higher margins vs. R&D. FY13 reflects a P:R&D ratio of 1.42x vs. 1.47x in FY12 (down largely due to a slowdown in F-35 production). However, the FYDP has the ratio increasing to 1.87x by FY17, a positive mix-shift for contractors. We note that the FY80-12 average is 1.9x.
- **Program Cuts** – Investment Accounts contribute \$24b in FY13 savings & \$111b over the FYDP. The largest contributors to the FYDP are LMT's F-35 (\$15b from slowed production) & shipbuilding (\$13b from stretched funding or support vessels/JHSVs being delayed). Most of the program decisions were largely as expected given all of DoD's previewing: NOC's Global Hawk Block 30 (\$2.5b) & DWSS (\$2.3b); BA's C-130 AMP (\$2.3b); BA/TXT's V-22 (\$1.7b). However, it's notable that DoD is also claiming savings on P-8A (\$5b, BA), THAAD (\$1.8b, LMT) & E-2D (\$500m, NOC).
- **Still More Wood to Chop** – Congress still has to debate the proposal (GOP already lining up against it) & appropriate funds. Over the last 5 years, the Congressional appropriation process has reduced the base budget & investment account by an avg. of 2%. Over the last 2 years, it has been 4% and 5%. FY13 likely fares better vs. the 2-year avg. since it's tough to cut defense in an election year. Also, Congress must address the sequester before it goes into effect in Jan (unlikely addressed until post-election).
- **Stock Call** – Our top defense picks for 2012 are still RTN & LMT due to their resilient portfolios (including international exposure) & balance sheet flexibility. In our view, there was little in this budget impacting these fundamentals. We also have Buys on GD (mostly for its Gulfstream bizjets), HII (margin opportunity) & NOC (focused portfolio despite top-line headwinds). This budget supports our view that military investment persists despite the coming drawdown. And in the meantime, companies will be able to generate EPS from resilient operations & strong cash generation.

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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# Base Budget Overview

## The FYDP Still Grows, but at a Slower Rate

The FY13 FYDP ignores sequestration, falling in line with Tranche 1 of the BCA.

As detailed in DoD's January 26 budget preview, the FY13 request ignores sequestration and propose a base budget of \$525b. The FYDP reflects 2.2% annual growth through FY17E in line with Tranche 1 of the Budget Control Act.

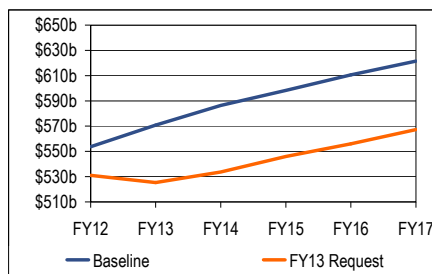
By slowing projected budget growth by 22 bps over the FYDP, DoD is claiming \$260b in savings. The main drivers of the slowed growth are O&M and Milpers, while the FY13-17 growth rate is actually higher for Investment, although it's coming off a lower base (Figure 1, Figure 2, Figure 3, Figure 4, Figure 5).

Figure 1. Slowing Growth to Save \$

<b>Base</b>	<b>(22 bps)</b>
Procurement	+105 bps
R&D	+47 bps
Investment	+72 bps
O&M	(62 bps)
Milpers & Other	(76 bps)

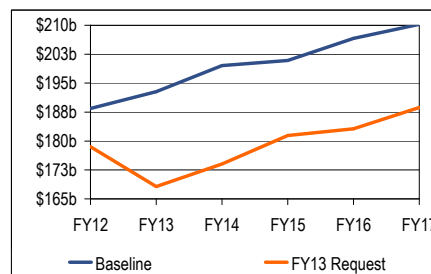
Source: Citi Investment Research and Analysis

Figure 2. Base Budget



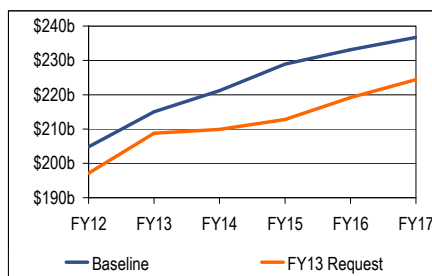
Source: Citi Investment Research and Analysis

Figure 3. Investment Account



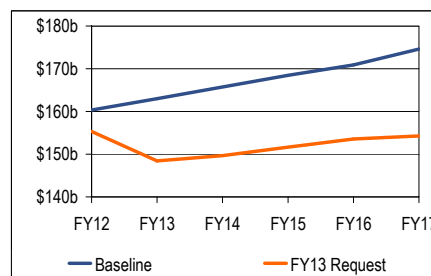
Source: Citi Investment Research and Analysis

Figure 4. O&M



Source: Citi Investment Research and Analysis

Figure 5. Milpers & Other



Source: Citi Investment Research and Analysis

Figure 6. Base Budget Request

Title	FY10 Actual	FY11 Actual	FY12 Enacted	FY13 Request	% Change (FY12-13)
Procurement	\$103.2	\$102.1	\$104.5	\$98.8	(5.5%)
RDT&E	79.3	75.3	71.4	69.4	(2.8%)
<b>Subtotal: Inv. Account</b>	<b>\$182.5</b>	<b>\$177.4</b>	<b>\$175.9</b>	<b>\$168.2</b>	<b>(4.4%)</b>
<b>Subtotal: O&amp;M</b>	<b>\$183.9</b>	<b>\$194.1</b>	<b>\$197.2</b>	<b>\$208.8</b>	<b>5.9%</b>
Military Personnel	135.7	137.8	141.8	135.1	(4.7%)
MilCons	20.5	14.8	11.4	9.6	(15.8%)
Family Housing	2.3	1.8	1.7	1.7	0.0%
Revolving & Management	3.1	2.4	2.6	2.0	(23.1%)
<b>Total Base</b>	<b>\$528</b>	<b>\$528.3</b>	<b>\$531</b>	<b>\$525</b>	<b>(1.0%)</b>

Source: Citi Investment Research and Analysis

Figure 7. Total Budget Request (including OCO)

Title	FY10 Actual	FY11 Actual	FY12 Enacted	FY13 Request	% Change (FY12-13)
Procurement	\$132.6	\$130.1	\$120.6	\$108.5	(10.0%)
RDT&E	79.8	76.3	71.9	69.6	(3.2%)
<b>Subtotal: Inv. Account</b>	<b>\$212.5</b>	<b>\$206.3</b>	<b>\$192.5</b>	<b>\$178.1</b>	<b>(7.5%)</b>
<b>Subtotal: O&amp;M</b>	<b>\$292.0</b>	<b>\$306.1</b>	<b>\$284.0</b>	<b>\$272.8</b>	<b>(3.9%)</b>
Military Personnel	152.5	154.1	153.1	149.2	(2.6%)
MilCons	21.9	14.8	11.7	9.6	(17.7%)
Other	12.1	4.6	4.5	4.2	(5.9%)
<b>Total</b>	<b>\$691.0</b>	<b>\$685.9</b>	<b>\$645.7</b>	<b>\$613.9</b>	<b>(4.9%)</b>

Source: Citi Investment Research and Analysis

## The Reduction Mix

The FY13 proposal removes \$260b from the previous budget plan, with 44% of the cuts coming from the investment account despite the fact that it comprises roughly a third of the budget. This is line with expectations since it takes longer to realize savings from non-modernization accounts. For this same reason, the cuts to the investment account are front-weighted (contribute 54% in FY13). Over the FYDP, the investment account's contribution comes down to 40% (in FY17), a trend we expect to continue in years thereafter as non-investment accounts are able to generate an increasing amount of savings (Figure 9).

Figure 8. FYDP Savings Contribution Rates

<b>Base</b>	<b>100%</b>
Procurement	37%
R&D	7%
Investment	44%
O&M	23%
Milpers & Other	33%

Source: Citi Investment Research and Analysis

Figure 9. Base Budget FYDP

Base (\$b)	FY11	FY12	FY13	FY14	FY15	FY16	FY17	FYDP
<b>Baseline</b>	<b>529.2</b>	<b>553.6</b>	<b>570.8</b>	<b>586.4</b>	<b>598.3</b>	<b>610.7</b>	<b>621.6</b>	<b>2.2%</b>
Nominal y/y growth		4.6%	3.1%	2.7%	2.0%	2.1%	1.8%	
<b>FY13 Request</b>	<b>529.2</b>	<b>531.0</b>	<b>525.4</b>	<b>533.6</b>	<b>545.9</b>	<b>555.9</b>	<b>567.3</b>	<b>1.9%</b>
Nominal y/y growth		0.3%	(1.1%)	1.6%	2.3%	1.8%	2.1%	
<b>Annual Savings vs. FY12 FYDP</b>								
FY13 Request		(23)	(45)	(53)	(52)	(55)	(54)	(260)
1000								
<b>Procurement (\$b)</b>	<b>FY11</b>	<b>FY12</b>	<b>FY13</b>	<b>FY14</b>	<b>FY15</b>	<b>FY16</b>	<b>FY17</b>	<b>FYDP</b>
<b>Baseline</b>	<b>103.2</b>	<b>113.0</b>	<b>117.0</b>	<b>125.9</b>	<b>129.7</b>	<b>137.2</b>	<b>139.8</b>	<b>4.5%</b>
Nominal y/y growth		9.5%	3.5%	7.6%	3.0%	5.8%	1.8%	
<b>FY13 Request</b>	<b>103.2</b>	<b>106.1</b>	<b>98.8</b>	<b>104.3</b>	<b>112.3</b>	<b>116.3</b>	<b>122.9</b>	<b>5.6%</b>
Nominal y/y growth		2.8%	(6.9%)	5.5%	7.7%	3.6%	5.6%	
<b>Annual Savings vs. FY12 FYDP</b>								
FY13 Request		(7)	(18)	(22)	(17)	(21)	(17)	(95)
Savings as % of total base budget savings			40%	41%	33%	38%	31%	37%
FY13 Request								
<b>R&amp;D (\$b)</b>	<b>FY11</b>	<b>FY12</b>	<b>FY13</b>	<b>FY14</b>	<b>FY15</b>	<b>FY16</b>	<b>FY17</b>	<b>FYDP</b>
<b>Baseline</b>	<b>75.0</b>	<b>75.4</b>	<b>75.8</b>	<b>73.6</b>	<b>71.1</b>	<b>69.4</b>	<b>70.5</b>	<b>(1.8%)</b>
Nominal y/y growth		0.6%	0.5%	(2.9%)	(3.4%)	(2.5%)	1.7%	
<b>FY13 Request</b>	<b>75.0</b>	<b>72.4</b>	<b>69.4</b>	<b>69.8</b>	<b>69.2</b>	<b>66.8</b>	<b>65.8</b>	<b>(1.3%)</b>
Nominal y/y growth		(3.4%)	(4.2%)	0.6%	(0.9%)	(3.4%)	(1.5%)	
<b>Annual Savings vs. FY12 FYDP</b>								
FY13 Request		(3)	(6)	(4)	(2)	(3)	(5)	(19)
Savings as % of total base budget savings			14%	7%	4%	5%	9%	7%
FY13 Request								
<b>Inv. Acct. (\$b)</b>	<b>FY11</b>	<b>FY12</b>	<b>FY13</b>	<b>FY14</b>	<b>FY15</b>	<b>FY16</b>	<b>FY17</b>	<b>FYDP</b>
<b>Baseline</b>	<b>178.2</b>	<b>188.5</b>	<b>192.8</b>	<b>199.5</b>	<b>200.9</b>	<b>206.6</b>	<b>210.3</b>	<b>2.2%</b>
Nominal y/y growth		5.8%	2.3%	3.5%	0.7%	2.8%	1.8%	
<b>FY13 Request</b>	<b>178.2</b>	<b>178.6</b>	<b>168.2</b>	<b>174.0</b>	<b>181.4</b>	<b>183.2</b>	<b>188.7</b>	<b>2.9%</b>
Nominal y/y growth		0.2%	(5.8%)	3.5%	4.3%	0.9%	3.0%	
<b>Annual Savings vs. FY12 FYDP</b>								
FY13 Request		(10)	(25)	(25)	(19)	(23)	(22)	(115)
Savings as % of total base budget savings			54%	48%	37%	43%	40%	44%
FY13 Request								
<b>O&amp;M (\$b)</b>	<b>FY11</b>	<b>FY12</b>	<b>FY13</b>	<b>FY14</b>	<b>FY15</b>	<b>FY16</b>	<b>FY17</b>	<b>FYDP</b>
<b>Baseline</b>	<b>198.1</b>	<b>204.8</b>	<b>215.0</b>	<b>221.2</b>	<b>228.9</b>	<b>233.1</b>	<b>236.7</b>	<b>2.4%</b>
Nominal y/y growth		3.4%	5.0%	2.9%	3.5%	1.8%	1.5%	
<b>FY13 Request</b>	<b>198.1</b>	<b>197.1</b>	<b>208.8</b>	<b>209.9</b>	<b>212.8</b>	<b>219.2</b>	<b>224.4</b>	<b>1.8%</b>
Nominal y/y growth		(0.5%)	5.9%	0.5%	1.4%	3.0%	2.4%	
<b>Annual Savings vs. FY12 FYDP</b>								
FY13 Request		(8)	(6)	(11)	(16)	(14)	(12)	(60)
Savings as % of total base budget savings			14%	21%	31%	25%	23%	23%
FY13 Request								
<b>Milpers &amp; Other (\$b)</b>	<b>FY11</b>	<b>FY12</b>	<b>FY13</b>	<b>FY14</b>	<b>FY15</b>	<b>FY16</b>	<b>FY17</b>	<b>FYDP</b>
<b>Baseline</b>	<b>152.9</b>	<b>160.3</b>	<b>163.0</b>	<b>165.7</b>	<b>168.5</b>	<b>170.9</b>	<b>174.6</b>	<b>1.7%</b>
Nominal y/y growth		4.8%	1.7%	1.6%	1.7%	1.5%	2.1%	
<b>FY13 Request</b>	<b>152.9</b>	<b>155.3</b>	<b>148.4</b>	<b>149.6</b>	<b>151.7</b>	<b>153.5</b>	<b>154.3</b>	<b>1.0%</b>
Nominal y/y growth		1.6%	(4.5%)	0.8%	1.3%	1.2%	0.5%	
<b>Annual Savings vs. FY12 FYDP</b>								
FY13 Request		(5)	(15)	(16)	(17)	(17)	(20)	(85)
Savings as % of total base budget savings			32%	30%	32%	32%	37%	33%
FY13 Request								

Source: Citi Investment Research and Analysis

Figure 10. Savings by Title (\$b)

Title	FY13	% of total	FYDP	% of total
Procurement	18	40%	94	36%
R&D	6	13%	17	7%
MilCons	5	11%	19	7%
MilPers	11	24%	69	27%
O&M	6	13%	60	23%
<b>Total (\$b)</b>	<b>45</b>		<b>259</b>	
Memo: Inv Acct	24	53%	111	43%

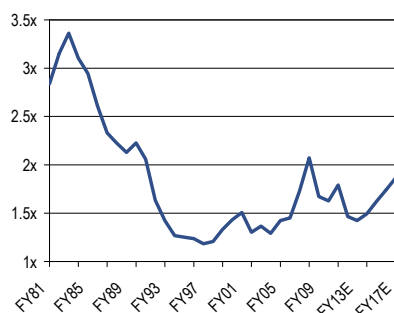
Source: DOD

Figure 11. Savings by Category (\$b)

Category	FY13	% of total	FYDP	% of total
Efficiencies	10	22%	61	24%
Force Structure	9	20%	53	20%
Modernization	18	40%	76	29%
Compensation	2	4%	29	11%
Other (includes R&D)	6	13%	40	15%
<b>Total (\$b)</b>	<b>45</b>		<b>259</b>	

Source: DoD

Figure 12. Historical P:R&D (FY81-FY17E)



Source: DoD, CIRA

## The Modernization Mix

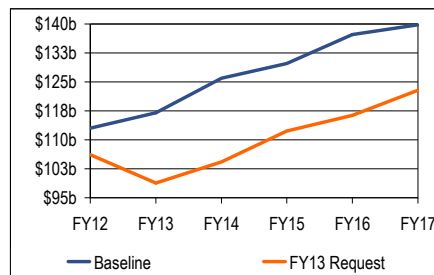
Within the base investment account, DoD continues to emphasize procurement over R&D, a positive mix-shift for defense industry margins since profitability in procurement is often tied to execution (~15% margins), whereas R&D margins are often capped as part of cost-plus contracts (~10% margins). We view this shift as positive for companies with proven abilities to execute. Although FY13 is down y/y, the FYDP has P:R&D rising from 1.42x in FY13 to 1.87x in FY17, approaching the FY80-10 average of 1.9x (Figure 13).

Figure 13. Procurement to R&D Ratio

FY13 Request	FY09A	FY10A	FY11A	FY12A	FY13	FY14	FY15	FY16	FY17
Procurement	102	104	103	106	99	104	112	116	123
R&D	80	80	75	72	69	70	69	67	66
<b>Investment Acct.</b>	<b>\$182.5</b>	<b>\$184.1</b>	<b>\$178.2</b>	<b>\$178.6</b>	<b>\$168.2</b>	<b>\$174.0</b>	<b>\$181.4</b>	<b>\$183.2</b>	<b>\$188.7</b>
<b>Total Base Budget</b>	<b>\$513.0</b>	<b>\$528.0</b>	<b>\$529.2</b>	<b>\$531.0</b>	<b>\$525.4</b>	<b>\$533.6</b>	<b>\$545.9</b>	<b>\$555.9</b>	<b>\$567.3</b>
<b>P:R&amp;D</b>	<b>1.27x</b>	<b>1.29x</b>	<b>1.38x</b>	<b>1.47x</b>	<b>1.42x</b>	<b>1.49x</b>	<b>1.62x</b>	<b>1.74x</b>	<b>1.87x</b>
Inv Acct. % of Total	35.6%	34.9%	33.7%	33.6%	32.0%	32.6%	33.2%	32.9%	33.3%

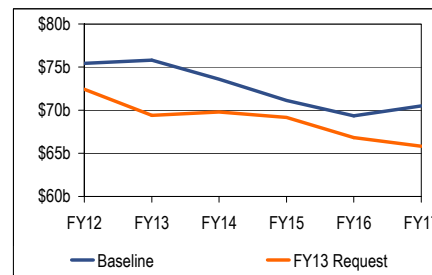
Source: Citi Investment Research and Analysis

Figure 14. Procurement



Source: Citi Investment Research and Analysis

Figure 15. R&D



Source: Citi Investment Research and Analysis

The request features new, lower targets for Army and Marine end-strength.

Figure 16. Active & Reserve End-Strength

Active Duty					
thousands	FY11	FY12	FY13	FY17	FY12-17
Army	481	562	552	490	(13%)
USMC	173	202	197	182	(10%)
Navy	378	326	323	320	(2%)
USAF	354	333	329	329	(1%)

Reserve & NG				
thousands	FY12	FY13	FY17	FY12-17
Army	205	205	205	0%
Navy	66	63	57	(14%)
USMC	40	40	40	0%
USAF	71	71	70	(3%)
Army NG	358	358	353	(1%)
Air NG	107	102	101	(5%)

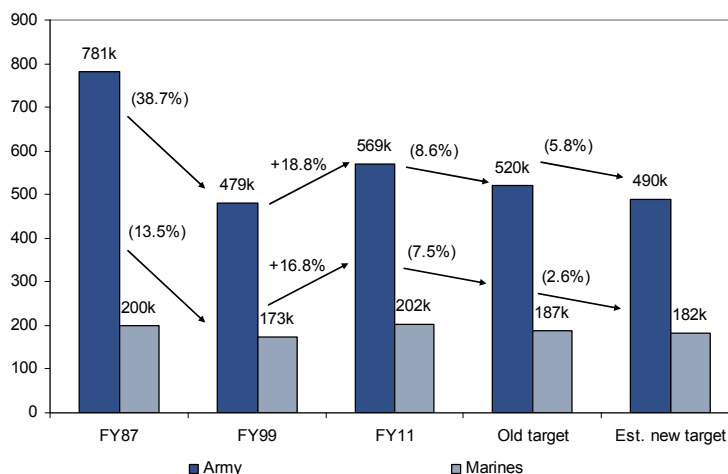
Source: Citi Investment Research and Analysis

Per head costs have skyrocketed over the last decade. The FY13 proposal begins to attack this cost growth by reducing end strength & limiting benefits/pay raises.

## End-strength

DoD is looking to buy-outs and early retirement options to reduce end-strength over the next 6 years. It plans to cut active duty ground forces, but maintain a surge capability with the reserves. Meanwhile, Navy and USAF active duty headcount is relatively resilient, while greater savings are being found in cuts to the reserves (Figure 16). All together, these moves contribute to the \$69b of savings found in the Military Personnel account over the FYDP (27% of FYDP savings). DoD has also introduced new, lower targets for Army and Marine end strength (vs. targets introduced in the FY12 proposal).

Figure 17. Lower Army & Marine End Strength Targets



Source: Citi Investment Research and Analysis

## Personnel & operations costs

DoD is proposing to reduce personnel costs by introducing some mild increases to healthcare fees and limiting pay raises. Over the FYDP, healthcare contributes \$13b of savings (5% of total) and military pay \$16.5b (6.4% of total). In our mind, this contributes to the \$129b in savings that MilPers and O&M are expected to contribute over the FYDP (50% of the total savings).

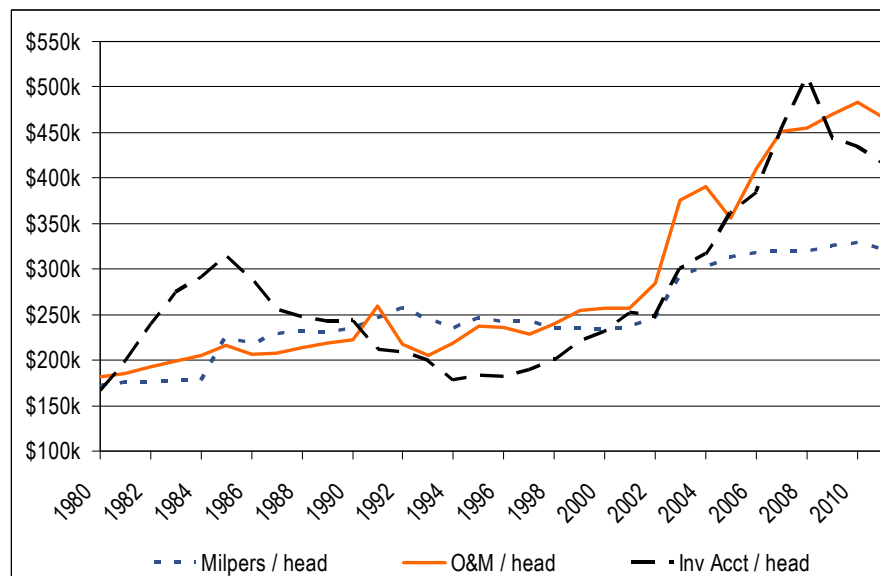
We note that the non-modernization budget (O&M + Milpers) per soldier was up 60% in FY11 vs. FY01 compared to FY01 vs. FY92 which was down 3%. The biggest driver of the increase in the 2000s was the Army, which is up 105% on a per head basis. While DoD is being careful not to reduce benefits for current soldiers, plans clearly contemplate adjusting the long-term cost-curve.

Also contributing to O&M savings are Force Structure reductions, which includes retiring ships and aircraft. We note that O&M costs alone were up 82% in FY11 vs. FY01 (Army is biggest driver up 172%).

While the investment account budget is up 65% over that same period (Army up 67%), plans to reduce end-strength yet maintain capabilities augur for relatively resilient per head spending in the investment account. See Figure 18 for per head costs by title since FY80.

Both O&M and Investment Accounts have skyrocketed on a per head basis over the last decade. We expect per head modernization spending to remain relatively resilient due to the need to field an increasingly modern military.

Figure 18. Per Head Budget by Title (constant \$000)



Source: DoD

## BRAC

Congress has said any new BRAC is dead on arrival.

The FY13 proposal and FYDP savings do not assume any costs or benefits from BRAC. In our view, this is the prudent approach seeing as numerous lawmakers have said that any BRAC proposals are dead on arrival. However, given the force structure reductions DoD is contemplating, BRAC authority would certainly help.

We suspect that DoD will hold BRAC, which is almost every Congressperson's worst nightmare, over the Congress' head in order to get them to come to a deficit reduction agreement so as to avoid the sequester which is set to go into effect in January 2013.

## Programs

DoD is claiming savings on programs in a number of ways: slowing procurement, reducing quantities, or simply shifting assumptions about future cost.

### F-35 Joint Strike Fighter (LMT, NOC)

179 F-35s are being delayed out of the FYDP. This is in line with expectations heading into the FY13 submission.

A reduction in F-35 production is expected to generate \$15b over 5Y. Figure 19 shows our estimated procurement schedule through FY17 which reflects 179 aircraft being delayed beyond the FYDP. We note that this information has been in the press for some time and that most sell-side estimates likely already reflect these reduced F-35 expectations. We note that DoD is still standing by its total acquisition objective.

Figure 19. Estimated JSF Procurement Schedule

	FY13	FY14	FY15	FY16	FY17	Total
FY12	42	62	81	108	130	423
New Plan	29	29	44	61	81	244
Units Cut	(13)	(33)	(37)	(47)	(49)	(179)

Source: Citi Investment Research and Analysis

### Shipbuilding (GD, HII)

The Navy is removing ships from its 5Y construction plan, but these are largely support vessels and JHSVs.

Although the Navy is removing ships from its 5Y plan and saving \$13b in the process, near-term revenues for the two main shipbuilders (HII and GD) are largely unaffected because ships are typically funded well in advance of construction and in increments. For instance, the zero funding request for LPDs in FY13 may shock at first glance, but we note that the last one (LPD 27) was funded in FY12 and won't deliver until late 2016. The Navy is also delaying the SSBN(X) to save \$4.3b over the FYDP. Design work is currently underway at GD, which we expect to continue at a low level for some time.

The Navy is also generating savings by slipping one VA-class submarine out of the FYDP. They have achieved this by reducing expected funding in FY13 and FY14 by 165 and 28% respectively. However, long-lead items for the most proximate boats are already funded and we do not expect these reductions to slow down the planned 2/year build-rate. We note that the 2 boats to begin construction in 2012 (SSN 788 and 789) were authorized in FY12 and will not deliver until 2018-2019.

### V-22 (BA, TXT)

DoD plans to save \$1.7b over the FYDP due to reductions in the V-22 buy and expected savings from the new multi-year procurement. Reducing MYP-2 to 98 aircraft through the end of the decade is in line with expectations and we expect BA/TXT to not complete negotiations until late this year.

### THAAD (LMT)

DoD plans to save \$1.8b over 5Y from THAAD by reducing the planned number of interceptors from 333 to 180 over the FYDP. In our mind, this is a mildly incremental negative for LMT as the reduced acquisition could limit Electronic Systems growth (mostly likely a headwind vs. previous expectations in 2013 and beyond, rather than in 2012).

## **P-8A (BA)**

DoD plans to save \$5.2b over the FYDP by reducing the planned procurement by 10. In our view, the program can still grow (funding is up 11% y/y in FY13) but at a slower rate.

## **E-2D (NOC)**

A similar story for E-2D which in our view still grows in 2012, but sees some headwinds as DoD is looking to save \$500m over the FYDP by reducing the program by 9 aircraft.

## **KC-46A (BA)**

DoD claims to be saving \$2.4b over the FYDP from the KC-46A program. In our view, this is merely a budget trick in which planners make new assumptions about the recently signed contract (which had not been signed at the time of the FY12 budget submission). In fact, KC-46A is receiving \$1b more in funding y/y in FY13.

## **Other programs**

Several other program decisions were in line with late January's FY13 budget preview:

- **RQ-4 Block 30 (NOC) termination** saves \$2.5b over 5Y
- **DWSS (NOC) termination** saves \$2.3b over 5Y
- **C-130 AMP (BA) termination** saves \$2.3b over 5Y.
- **C-27J (Alenia, LLL) termination** saves \$400m over 5Y.
- **Ground Combat Vehicle (GD, BAE) delay** saves \$1.3b over 5Y.

## Program FYDPs

Our initial review of program spending plans does not uncover funding plans that depart materially from the decisions DoD highlights in its briefing materials.

Figure 20. Selected Programs of Note

Program	Program Detail	Prime(s)	FY13					FY13-16 Aggregate Funding			Comment
			FY13	FY14	FY15	FY16	FY17	FY12 Plan	FY13 Plan	Delta	
C-130	AC-130 Recap	LMT	164	496	20	20	0	1,472	701	(52%)	Likely due to decision to retire aircraft
C-130	C-130 AMP	BA	0	0	0	0	0	1,878	0	(100%)	Program termination
C-130	C-130J	LMT	68	1,032	905	648	36	1,565	2,654	70%	Increased demand
C-130	HC-130 Recap	LMT	152	337	253	487	251	1,126	1,229	9%	
C-130	MC-130 Recap	LMT	375	675	206	638	591	1,608	1,893	18%	
C-27	C-27J	LLL, Fin	0	0	0	0	0	364	0	(100%)	Program termination
E-2D	E-2D	NOC	985	1,151	1,397	1,346	1,519	5,865	4,879	(17%)	Reduced quantities/slower procurement
F-18	F/A-18 E/F (MYP)	BA/NOC	2,065	1,140	0	0	0	3,419	3,206	(6%)	
F-35	F-35A Procurement	LMT/NOC	3,418	3,358	4,547	6,026	5,949	27,680	17,349	(37%)	Delay F-35 procurement
F-35	F-35A R&D	LMT/NOC	1,193	985	603	358	156	3,101	3,138	1%	Maintain F-35 development
F-35	F-35B Procurement	LMT/NOC	1,511	1,521	1,562	1,953	2,577	7,697	6,547	(15%)	Delay F-35 procurement
F-35	F-35B R&D	LMT/NOC	737	693	575	448	340	2,491	2,454	(1%)	Maintain F-35 development
F-35	F-35C Procurement	LMT/NOC	1,073	1,274	1,432	1,724	2,430	11,416	5,503	(52%)	Delay F-35 procurement
F-35	F-35C R&D	LMT/NOC	744	702	584	458	350	2,502	2,489	(1%)	Maintain F-35 development
Global Hawk	RQ-4 BAMS Procurement	NOC	51	70	89	91	88	0	302	NA	Increase funding for Navy's Global Hawk
Global Hawk	RQ-4 Mods	NOC	9	9	9	10	7	300	37	(88%)	Block 30 cancellation
Global Hawk	RQ-4 Procurement	NOC	75	25	0	0	0	1,479	100	(93%)	Block 30 cancellation
Helo	CH-47	BA	1,391	915	927	1,190	1,280	4,189	4,423	6%	
Helo	H-1	TXT	820	845	842	828	975	3,281	3,335	2%	
Helo	OH-58	TXT	192	342	486	578	536	1,114	1,598	43%	Kiowa upgrades (as opposed to new program)
Shipbuilding	Carrier RCOH	HII	1,863	2,026	611	2,383	2,772	6,551	6,883	5%	
Shipbuilding	Carrier Replacement	HII	608	1,143	3,464	1,696	2,900	10,327	6,912	(33%)	Slowed funding profile, but not construction
Shipbuilding	DDG-1000	GD, HII, RTN	669	173	322	0	0	1,204	1,165	(3%)	
Shipbuilding	DDG-51	HII, GD	3,522	2,025	3,034	3,566	4,119	12,392	12,147	(2%)	
Shipbuilding	JHSV	Austal	220	35	34	14	9	1,448	303	(79%)	Removed 8 JHSVs from FYDP
Shipbuilding	LCS	LMT, Austal	1,845	1,896	2,014	1,147	1,106	7,541	6,902	(8%)	
Shipbuilding	LHA	HII	163	10	96	254	2,113	1,897	524	(72%)	Slip 1 out of the FYDP
Shipbuilding	VA-Class	HII, GD	4,164	4,684	6,354	5,804	5,618	23,207	21,006	(9%)	Slip 1 out of the FYDP
V-22	MV-22 Procurement	BA/TXT	1,457	1,494	1,584	1,516	1,495	7,460	6,052	(19%)	Reduce MYP 2 quantities

Source: Citi Investment Research and Analysis, DoD

## Major Weapons Systems

Below is a selection of the top requested programs in FY13. Year to year moves do not concern us greatly since many large procurement programs are funded incrementally or they're scheduled to wind down in a particular year. Therefore, we do not consider this list as instructive as the above program FYDPs

Figure 21. FY13 Major Weapon Systems

System	FY11	FY12	FY13	FY13 vs. FY12			Prime(s)
	Total	Total	Total	R&D	Procurement	Total	
Ballistic Missile Defense	10,460	10,431	9,721	(5%)	(13%)	(7%)	BA; LA; NOC; RTN
F-35 Joint Strike Fighter	9,682	9,246	9,171	(0%)	(1%)	(1%)	LMT, NOC
VA-Class	5,260	4,795	4,258	47%	(13%)	(11%)	GD; HII
DDG 51 AEGIS Destroyer	2,900	2,081	3,515	NA	69%	69%	GD; HII
P-8A Poseidon	2,909	2,935	3,258	(32%)	23%	11%	Airframe: BA; Engine: CFM
Littoral Combat Ship	1,474	2,111	2,246	47%	(0%)	6%	LMT
F/A-18E/F Super Hornet	2,342	2,452	2,182	3%	(12%)	(11%)	Airframe: BA; Engine: GE
V-22 Osprey	2,834	2,789	1,955	(16%)	(30%)	(30%)	Bell Helicopter
KC-46A New Tanker	539	877	1,816	107%	NA	107%	BA
Trident II Modifications	1,329	1,584	1,513	20%	(6%)	(4%)	LMT
CH 47 Chinook	1,430	1,409	1,462	46%	2%	4%	BA
Aegis	1,814	1,554	1,382	0%	(31%)	(11%)	LMT, RTN
Global Positioning System	889	1,465	1,264	(16%)	(11%)	(14%)	LMT; RTN
RQ-4 Global Hawk	1,611	1,456	1,251	14%	(70%)	(14%)	NOC
WIN-T	693	1,064	1,226	50%	8%	15%	GD; LMT
AH-64 (New Build/ReMan)	582	758	1,180	34%	59%	56%	NOC; LMT; Apache: BA
E-2D Advanced Hawkeye	1,316	1,206	1,159	(9%)	(3%)	(4%)	NOC, LMT (Radar)
EA-18G Growler	1,029	1,040	1,075	(24%)	4%	3%	Airframe: BA; Engine: GE
Joint Tactical Radio System	821	1,244	1,053	(50%)	25%	(15%)	GD, LMT, ViaSat, BAE, COL, XLS
H-1 Huey/Super Cobra	940	802	852	(54%)	12%	6%	Bell Helicopter
C-130J Hercules	1,302	1,429	835	(19%)	(43%)	(42%)	LMT
F-22 Raptor	1,198	916	809	(10%)	(14%)	(12%)	LMT; BA, Pratt & Whitney
THAAD	1,004	999	778	9%	(35%)	(22%)	LMT
Stryker	1,586	772	332	(78%)	(55%)	(57%)	GD
JPATS T-6B Texan II	26	264	286	NA	8%	8%	Hawker Beechcraft
Joint High Speed Vehicle	390	376	191	(54%)	(49%)	(49%)	Austal
Mobile User Objective System	895	482	167	(40%)	(91%)	(65%)	LMT
Joint Light Tactical Vehicle	49	134	117	(17%)	(5%)	(13%)	In Development
M-1 Abrams Tank Upgrade	294	453	74	(100%)	(83%)	(84%)	GD
Wideband Global SATCOM	620	793	37	NA	(95%)	(95%)	BA

Source: DoD

## Supplemental Budget

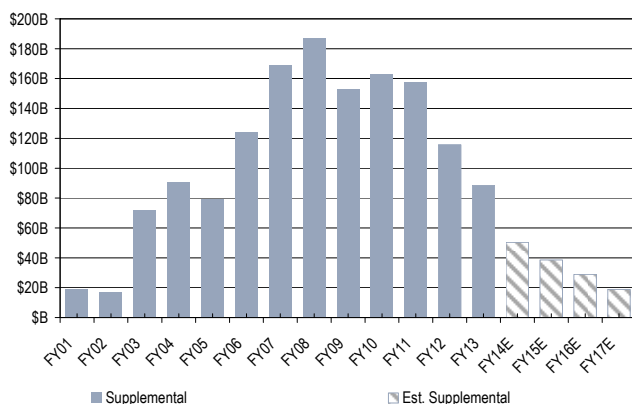
**The investment account comprises 11% of the supplemental request, or \$10b. We expect its share and the supplemental budget itself to continue falling through FY17.**

The FY13 Supplemental request came in as expected at \$88.5b, down 23% y/y. DoD is using a \$44.2b placeholder for the out years (vs. the previous practice of using \$50b). We note that the supplemental is not subject to Budget Control Act and therefore presents an opportunity for DoD to skirt some of the caps. However, at this point, DoD appears to be refraining from "stuffing the supplemental."

We note that the FY13 supplemental investment account (\$10b or 11% of the supplemental request) is the lowest it has been since FY04 on an absolute basis and relative basis. This compares to FY08's peak of 46%. We expect the investment account's share to continue to drift down (Figure 23).

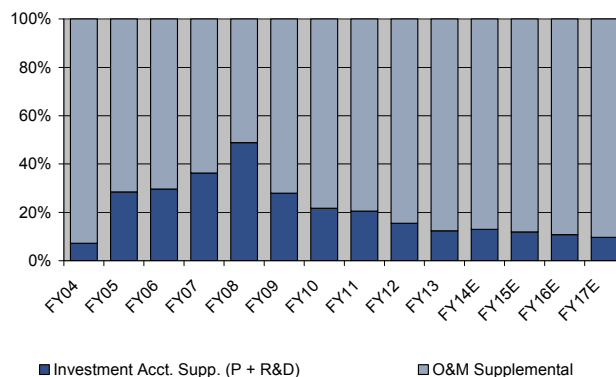
We note that although there are no longer troops in Iraq and the Afghan withdrawal is underway, American presence in the region isn't ending. The State Department in Baghdad is establishing one of the largest (and most secure) embassies in the world, while we expect some contingent of US security support staff to remain in Afghanistan for years. Also, to the extent that the uniformed military is not allowed to protect the Baghdad Embassy, we expect private contractors to have to fill the space. For that reason, we see the OCO budget sticking around for some time although we expect it to continue to fall (we see ~\$20b in FY17E) (Figure 22).

Figure 22. Supplemental Budget (FY01-FY17E)



Source: Citi Investment Research and Analysis, DOD

Figure 23. Investment Account Share of OCO



Source: Citi Investment Research and Analysis

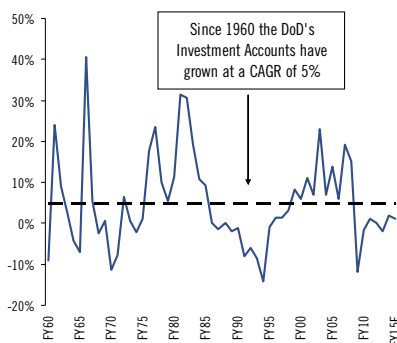
## What's Priced In?

It appears that investors are pricing in little, and in some cases negative growth, for defense stocks indefinitely. We arrive at this conclusion by using a reverse DCF: calculating the implied firm value of each company using unlevered free cash flow for 2011, WACC, and a zero growth assumption. After backing out net debt, we arrive at an implied equity value, and compare it to the company's current market capitalization (Figure 25). When the zero-growth market value exceeds current market cap, shares are implying expectations of indefinite reductions in cash flow. We note that GD screens better in this analysis likely due to the company's commercial bizjet exposure.

In our view, this view is too pessimistic in light of the fact that DoD investment accounts grew at a CAGR of 5% from 1960 to 2009 and at a CAGR of 3% from 1960 to 2000 (Figure 24). Plus, the FY13 budget continues to reflect growth in investment accounts. While we expect to see headwinds in the near-term amidst the coming drawdown, there is no reason to believe that perpetual declines are in the cards.

In short, DoD investment accounts grow over time, something that shares do not currently reflect.

Figure 24. Y/Y Investment Acct Growth



Source: Citi Investment Research and Analysis

Figure 25. Zero Growth Market Valuation

	Zero-Growth Mkt Value (\$m)	Current Mkt Value (\$m)	Mkt Value Attributable to Zero Growth	Mkt-Implied Perpetual FCF Growth Rate
<b>GD</b>	\$26,947	\$25,035	107.6%	(0.7%)
<b>LMT</b>	\$44,454	\$28,099	158.2%	(3.8%)
<b>NOC</b>	\$23,685	\$15,185	156.0%	(4.9%)
<b>RTN</b>	\$26,621	\$17,137	155.3%	(4.3%)

Source: Citi Investment Research and Analysis

## Stock Performance

Defense primes have mildly underperformed the market YTD (by 150 bps), including two important DoD briefings:

For more on the Jan 5 DoD briefing see: [Underweight Europe, Overweight Asia - New Pentagon strategy calls for focused investment.](#)

For more on the Jan 26 DoD briefing see: [The Axe Begins to Fall - Time for a New Kind of Down-cycle Focused on Modernization.](#)

1. Defense primes have rallied ~6% (50 bps better than the S&P500) since January 5's qualitative results of the Comprehensive Strategic Review which highlighted that US military strategy would make a strategic pivot towards Asia and the Middle East underlining the importance of airborne and naval assets.
2. Primes are up 2% (40 bps behind the market) since January 26's FY13 budget preview (impacted by 4Q11 earnings season), which reported on several programs facing termination and reductions, as well as indicating how 5Y savings would be culled from a variety of sources.

In our view, both briefings and the FY13 budget proposal highlighted that this defense drawdown will stay focused on continuing to invest in modernization opportunities at the expense of adjusting the long-term cost curves in the O&M and personnel accounts.

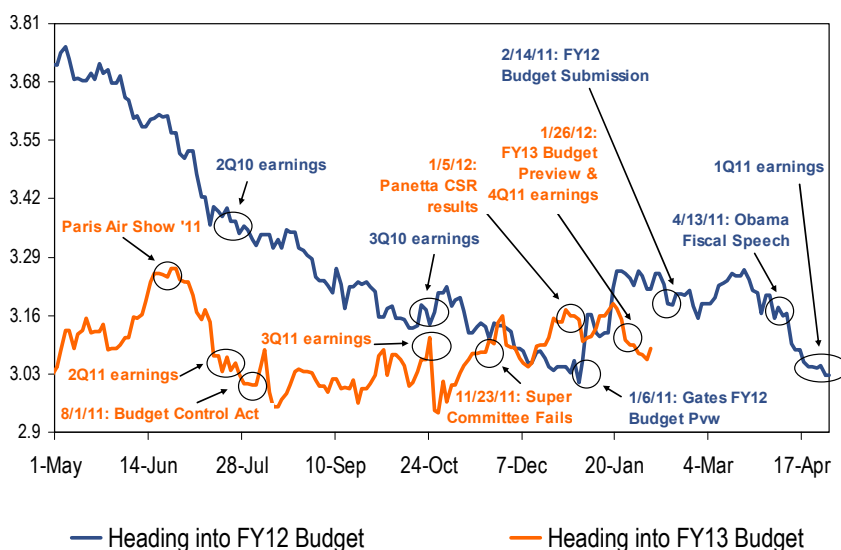
To be sure, this will have top-line implications for the contractors, especially those that have seen strong growth from war spending over the last decade. However, the fundamentals remain strong as investors seemingly shrugged off negative top-line guidance and instead focused on strong cash trends and dividend/repurchase opportunities. See the most recent edition of our global weekly, *The Itinerary*, for more on 2012 defense guidance: [Digesting the Down-Cycle.](#)

We expect confidence to persist through the FY13 budget process despite the lumps and the threat of sequestration. Why? Because despite the challenging funding environment, defense fundamentals including margin trajectory, cash generation, and most importantly the threat environment remain intact. And we expect Congress to come up with some way to avoid sequestration in January 2013.

In the weeks following the FY12 submission in February 2011, confidence coalesced around resilient defense budgets & shares outperformed. Obama's fiscal speech in April 2011 put an end to the rally when he outlined the need for further defense cuts. In our view, the FY13 proposal should also create some confidence in DoD's focus on maintaining investments and we do not expect another Obama speech to derail said confidence.

The election cycle should prove positive as politicians don't want to appear weak, but the partisanship likely pushes a sequestration solution to the post-election timeframe.

Figure 26. Defense Prime Relative Price (vs. S&P)



Source: Citi Investment Research and Analysis  
Note: Defense Primes include GD, LMT, NOC, RTN.

## General Dynamics Corp.

(GD.N; US\$70.12; 1)

### Valuation

Historically, shares of GD have traded at 14x FTM P/E and at a 12% discount to the S&P500. While we concede that defense industry multiples are not likely to return to levels seen during the recent war build-up, we do argue that they should return to the levels seen during the Post-Consolidation & Stable Demand era between 1995 and 2001 – a period that best reflects the current environment, in our view. During this period, ex-the dotcom bubble, defense shares traded at a 25% discount to the S&P 500. We apply a 25% discount to the market multiple of ~12.5x to arrive at our target defense multiple of ~9.4x.

For the company's commercial aerospace business, we apply a multiple in line with a basket of commercial aerospace companies (15x). Our blended target multiple is calculated as following:

- Defense multiple =  $75\% \times 12.5x = 9.4x$ , applied to 71% of income
- Commercial multiple = 15x, applied to 29% of income

The result is a blended multiple of 11x, below the 10-yr average of 14x likely due to the premium assigned to defense during wartime. Applied to our FTM EPS estimate twelve months from now, we arrive at our \$85 price target. On an EV/EBITDA basis, our price target implies a ~7x EV/EBITDA multiple, vs. the 10-yr average of 9.5x.

### Risks

GD's strengths (large capitalization, low earnings and share price volatility, investment grade balance sheet, and historically strong cash flows) are offset by the risk inherent in having ~70% of revenues tied to one customer (a fiscally pressured US government), and by being exposed to inherently risky aircraft development programs.

Risks to the upside include on-going conflicts requiring defense spending on vehicles and munitions beyond our current expectations. There may also be a sooner-than-expected broad revival in business jet demand and commercial shipbuilding.

Risks to the downside include a further deterioration of global economic environment, both of which would put pressure on government spending and negatively impact domestic and international sales (commercial and government). Defense acquisition reform could also become a negative for industry margins, although we are not overly concerned with its current iteration. Also, an end to the current conflicts may further erode the need for land-based combat systems, while strategic priorities may obviate the need for major naval platforms. Aircraft development programs can also slip schedule- and cost-wise due to unforeseen contingencies.

If the impact on the company from any of these factors proves to be greater/less than we anticipate, we believe the stock will likely have difficulty achieving our target price or could outperform it.

## Huntington Ingalls Industries

(HII.N; US\$36.55; 1)

### Valuation

Our target price of \$36 is derived by applying a 9x multiple to our FTM EPS est. 12 months from now. This represents a ~25% discount to the market (currently at ~12x), in line with where defense shares have historically traded during spending environments similar to this one (slowing demand). We assign an in-line defense multiple seeing as HII's revenue concentration (downward pressure on valuation) is offset by its above-average margin expansion opportunity (upward pressure on valuation).

### Risks

We believe the relatively levered business is offset by positive cash flow dynamics due to improving operations and recoverable restructuring costs. Execution risk is mitigated by what we consider to be an achievable path for getting back to industry-standard margins (HII's comparable already does 9-10% margins while HII's poorly priced ships are scheduled to deliver by 2013). And in our view, heavy customer concentration (almost 100% US Navy or Coast Guard) is offset by strong revenue visibility. However, this is reliant on a smooth wind-down at Avondale, which could incur higher than expected restructuring costs related to employee retention and work delays through 2013.

A pending False Claims Act complaint regarding misuse of Hurricane Katrina funds is another source of risk, although the company believes the claims are not likely to result in a material adverse effect. Other risks that could prevent shares from reaching our target include: reduced requirements from shifts in military strategy; a competitive contracting environment; new Naval shipbuilding priorities eating into existing procurement plans (Virginia-class); and rising competition from in-sourced work at Navy shipyards as they enhance their capabilities. Broader budget pressure is also a risk given the high price tag of most Naval platforms, making them a relatively easy target for cutting. History also tells us that acts of god can negatively affect the shipbuilding business, especially in the Gulf Coast.

If the impact on the company from any of these factors proves to be greater/less than we anticipate, we believe the stock will likely have difficulty achieving our target price or could outperform it.

## Lockheed Martin Corp.

(LMT.N; US\$88.23; 1)

### Valuation

Over the past decade, LMT shares have historically traded at 16x and roughly flat to the S&P 500. While we concede that defense industry multiples are not likely to return to levels seen during the last decade, we do argue that they should return to the levels seen during similar demand environments of the past, specifically the Post-Consolidation & Stable Demand era between 1995 and 2001, a period that best reflects the current environment, in our view. During this period (ex-the dotcom bubble) defense shares traded at a 25% discount to the S&P 500 (14x). We believe LMT should trade at a mild premium (a 20% discount to the market) due to the sales and earnings growth potential embedded in the F-35 program. We therefore apply a 10.1x multiple to our FTM EPS estimates one year from now to arrive at our \$92 price target.

## Risks

Strength derived from Lockheed Martin's large capitalization, low earnings and share price volatility, investment grade balance sheet, and historically strong cash flows, are offset by the fact that 90% of its revenues are tied to a US government customer. Domestic fiscal pressures are the most prominent downside risk, as a significant reduction in government spending would negatively impact domestic and international sales. And although we do not judge its current iteration as a major threat, acquisition reform could become a negative for industry margins. Upside and downside risks also emanate from geopolitical events impacting alliance structures and cross-border relationships, which would change defense spending habits and thus impact industry multiples. The company's marquee program, the F-35 JSF, is facing negative headlines and Congressional heat over its cost, and runs the risk of being slowed/delayed (although we do not believe the program will erode significantly due to its strategic importance).

If the impact on the company from any of these factors proves to be greater/less than we anticipate, we believe the stock will likely have difficulty achieving our target price or could outperform it.

## Northrop Grumman Corp.

(NOC.N; US\$60.30; 1)

### Valuation

Historically, NOC shares have traded at 14x and at a 30% discount to the S&P 500. While we concede that defense industry multiples are not likely to return to levels seen during the most recent war build-up, we do argue that they should return to the levels seen during the spending era that best reflects the current environment, specifically the post-consolidation, stable demand environment era between 1995 and 2001. At that time (ex-the dotcom bubble), defense shares traded at a 25% discount to the market (which currently trades at ~12x). As such we apply 9.4x (75% of 12.5x) to our FTM EPS estimate a year from now to arrive at our PT of \$69.

### Risks

Northrop's large capitalization, low earnings and share price volatility, investment grade balance sheet, and historically strong cash flows, are offset by the fact that ~91% of its revenues are tied to one customer: the US government (mostly the Defense Department). Risks to the downside include a further deterioration of global economic environment and the domestic fiscal situation, both of which would put pressure on government spending and trading multiples. And although we do not judge its current iteration as a major threat, acquisition reform and pentagon-led efficiency drives could become a negative for industry margins. Also, strategic priorities may reduce the need for major platforms, including the F-35 JSF which faces negative headlines and congressional heat over its cost (although we expect NOC to be able to offset some of the weakness with its F/A-18 content). Further downside risks emanate from geopolitical events which could impact defense spending habits and industry multiples.

If the impact on the company from any of these factors proves to be greater/less than we anticipate, the stock could have difficulty achieving our target price/outperform it.

## Raytheon Co.

(RTN.N; US\$50.31; 1)

### Valuation

Historically, shares of RTN have traded at 14x and at a 20% discount to the S&P 500. While we concede that defense industry multiples are not likely to return to levels seen during the most recent war build-up, we do argue that they should return to the levels seen during the post-consolidation, stable demand environment era between (1995-2001), a period that best reflects the current environment. During this period (ex-the dotcom bubble) defense shares traded at a 25% discount to the market. We believe that RTN should trade at a slight premium due to its diversified portfolio, its higher margin profile, as well as its industry-leading international exposure. As such, we apply a multiple of 10x (20% discount to market multiple of ~12.6x) to our FTM EPS estimates one year from now to arrive at our \$59 price target.

### Risks

RTN's large capitalization, earnings and share price volatility, investment grade balance sheet, and historically strong cash flows are offset by ~88% of its revenues being tied to one customer: the US government, and primarily the Defense Department. Risks to the downside include a further deterioration of global economic environment and the domestic fiscal situation, both of which would put pressure on government spending and trading multiples. And although we do not judge its current iteration as a major threat, acquisition reform could become a negative for industry margins. Meanwhile, both upside and downside risks emanate from geopolitical events which would change defense spending habits and industry multiples.

If the impact on the company from any of these factors proves to be greater/less than we anticipate, we believe the stock will likely have difficulty achieving our target price or could outperform it.

## Appendix A-1

### Analyst Certification

The research analyst(s) primarily responsible for the preparation and content of this research report are named in bold text in the author block at the front of the product except for those sections where an analyst's name appears in bold alongside content which is attributable to that analyst. Each of these analyst(s) certify, with respect to the section(s) of the report for which they are responsible, that the views expressed therein accurately reflect their personal views about each issuer and security referenced and were prepared in an independent manner, including with respect to Citigroup Global Markets Inc and its affiliates. No part of the research analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) expressed by that research analyst in this report.

### IMPORTANT DISCLOSURES

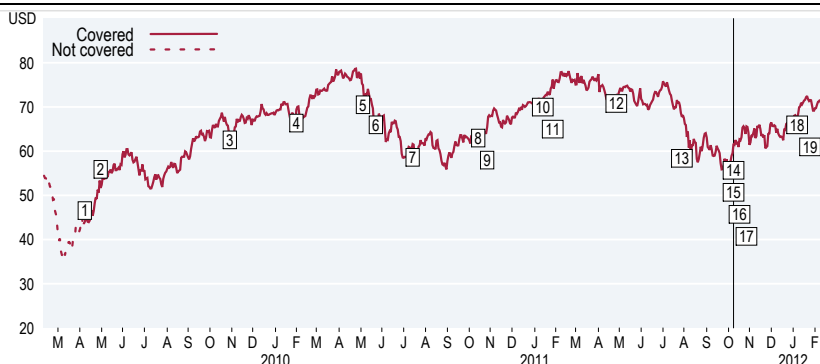
#### General Dynamics Corp. (GD)

##### Ratings and Target Price History

##### Fundamental Research

Analyst: Jason Gursky

Covered since July 15 2010



	Date	Rating	Target Price	Closing Price
1	8-Apr-09	*3M	*34.00	44.00
2	30-Apr-09	3M	*45.00	51.67
3	29-Oct-09	3M	*59.00	63.65
4	31-Jan-10	3M	*63.00	66.85
5	5-May-10	3M	*67.00	74.96
6	24-May-10	*2M	67.00	65.96
7	14-Jul-10	*2H	*69.00	61.61

\* Indicates change

	Date	Rating	Target Price	Closing Price
8	14-Oct-10	2H	*71.00	63.17
9	27-Oct-10	2H	*75.00	65.42
10	13-Jan-11	*1H	*87.00	71.78
11	27-Jan-11	1H	*88.00	76.20
12	27-Apr-11	1H	*91.00	72.72
13	28-Jul-11	1H	*90.00	67.75
14	8-Oct-11	Stock rating system changed		

	Date	Rating	Target Price	Closing Price
15	8-Oct-11	*1	90.00	59.55
16	18-Oct-11	1	*86.00	62.64
17	27-Oct-11	1	*87.00	65.61
18	6-Jan-12	1	*88.00	67.62
19	25-Jan-12	1	*85.00	71.57

Rating/target price changes above reflect Eastern Standard Time

#### General Dynamics Corp. (GD)

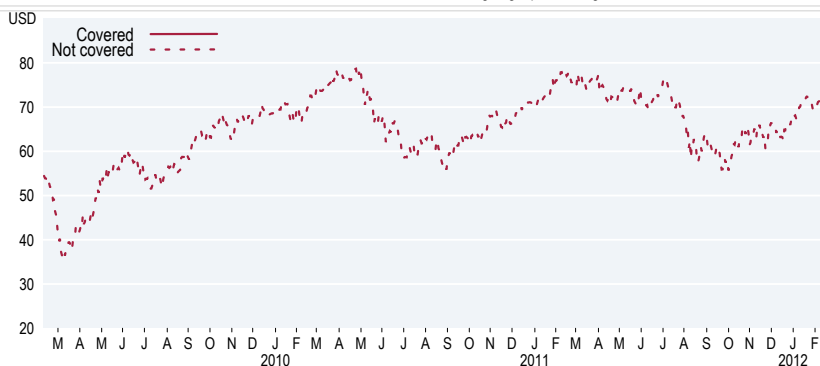
##### Ratings and Target Price History

##### Best Ideas Research

##### Relative Call (3 Month)

Analyst: Jason Gursky

Covered since July 15 2010



\* Indicates change

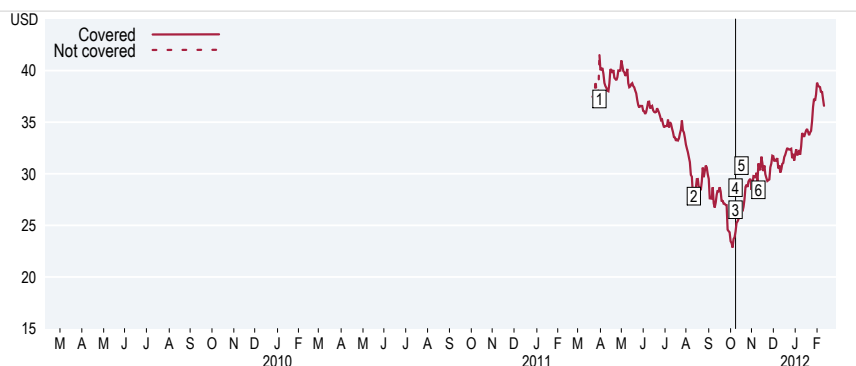
Rating/target price changes above reflect Eastern Standard Time

## Huntington Ingalls Industries (HII)

### Ratings and Target Price History Fundamental Research

Analyst: Jason Gursky

Covered since March 31 2011



	Date	Rating	Target Price	Closing Price
1	31-Mar-11	*1M	*\$44.00	41.50
2	11-Aug-11	1M	*\$35.00	27.83

\* Indicates change

	Date	Rating	Target Price	Closing Price
3	8-Oct-11	Stock rating system changed		
4	8-Oct-11	*1	35.00	23.85

	Date	Rating	Target Price	Closing Price
5	18-Oct-11	1	*\$32.00	26.47
6	10-Nov-11	1	*\$36.00	31.00

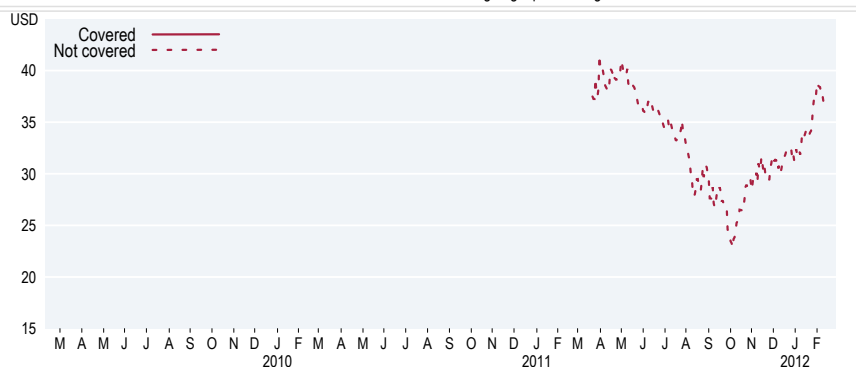
Rating/target price changes above reflect Eastern Standard Time

## Huntington Ingalls Industries (HII)

### Ratings and Target Price History Best Ideas Research Relative Call (3 Month)

Analyst: Jason Gursky

Covered since March 31 2011



\* Indicates change

Rating/target price changes above reflect Eastern Standard Time

## Lockheed Martin Corp. (LMT)

### Ratings and Target Price History Fundamental Research

Analyst: Jason Gursky

Covered since July 15 2010



	Date	Rating	Target Price	Closing Price
1	8-Apr-09	*2M	*\$75.00	72.70
2	21-Apr-09	2M	*\$78.00	76.04
3	31-Aug-09	*1M	*\$90.00	74.98
4	20-Oct-09	1M	*\$86.00	71.99
5	5-May-10	1M	*\$95.00	84.84
6	14-Jul-10	*1H	*\$97.00	75.50

\* Indicates change

	Date	Rating	Target Price	Closing Price
7	14-Oct-10	1H	*\$91.00	70.20
8	24-Oct-10	1H	*\$88.00	71.78
9	28-Jan-11	1H	*\$100.00	78.20
10	26-Apr-11	1H	*\$104.00	79.04
11	15-Jul-11	1H	*\$102.00	78.37
12	8-Oct-11	Stock rating system changed		

	Date	Rating	Target Price	Closing Price
13	8-Oct-11	*1	102.00	74.00
14	18-Oct-11	1	*\$92.00	75.98
15	27-Oct-11	1	*\$89.00	75.65
16	26-Jan-12	1	*\$92.00	82.47

Rating/target price changes above reflect Eastern Standard Time

## Lockheed Martin Corp. (LMT)

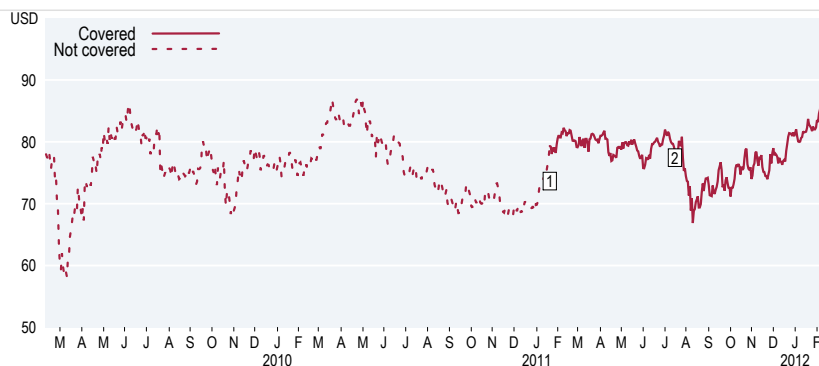
### Ratings and Target Price History

#### Best Ideas Research

#### Relative Call (3 Month)

Analyst: Jason Gursky

Covered since July 15 2010



	Date	Rating	Target Price	Closing Price
[1]	20-Jan-11	*ADD MP	-	79.32

\* Indicates change

	Date	Rating	Target Price	Closing Price
[2]	15-Jul-11	*REM MP	-	78.37

Rating/target price changes above reflect Eastern Standard Time

## Northrop Grumman Corp. (NOC)

### Ratings and Target Price History

#### Fundamental Research

Analyst: Jason Gursky

Covered since July 15 2010



	Date	Rating	Target Price	Closing Price
[1]	8-Apr-09	2M	*42.64	40.88
[2]	22-Apr-09	2M	*43.54	43.34
[3]	23-Oct-09	2M	*46.27	45.05
[4]	25-Feb-10	2M	*56.25	55.45
[5]	5-May-10	2M	*62.60	60.67
[6]	14-Jul-10	*1H	62.60	51.70

\* Indicates change

	Date	Rating	Target Price	Closing Price
[7]	27-Oct-10	1H	*66.22	55.68
[8]	10-Feb-11	1H	*77.11	64.55
[9]	31-Mar-11	1H	*76.00	62.71
[10]	28-Apr-11	1H	*79.00	63.09
[11]	15-Jul-11	1H	*83.00	64.62
[12]	27-Jul-11	1H	*80.00	62.68

	Date	Rating	Target Price	Closing Price
[13]	8-Oct-11	Stock rating system changed		
[14]	8-Oct-11	*1	80.00	52.81
[15]	18-Oct-11	1	*71.00	54.40
[16]	27-Oct-11	1	*69.00	57.64

Rating/target price changes above reflect Eastern Standard Time

## Northrop Grumman Corp. (NOC)

### Ratings and Target Price History

#### Best Ideas Research

#### Relative Call (3 Month)

Analyst: Jason Gursky

Covered since July 15 2010

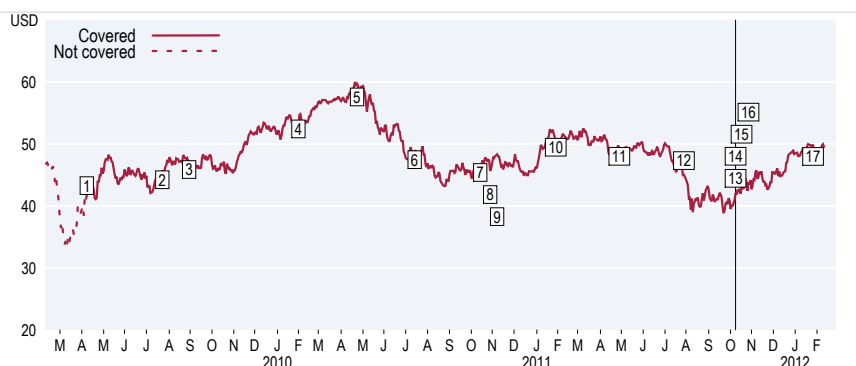


\* Indicates change

Rating/target price changes above reflect Eastern Standard Time

# Raytheon Co. (RTN) Ratings and Target Price History Fundamental Research

Analyst: Jason Gursky  
Covered since July 15 2010



	Date	Rating	Target Price	Closing Price
1	8-Apr-09	1M	*48.00	41.76
2	23-Jul-09	1M	*52.00	45.75
3	31-Aug-09	*2M	52.00	47.18
4	31-Jan-10	2M	*57.00	52.43
5	23-Apr-10	2M	*61.00	59.72
6	14-Jul-10	*1H	*60.00	48.57

\* Indicates change

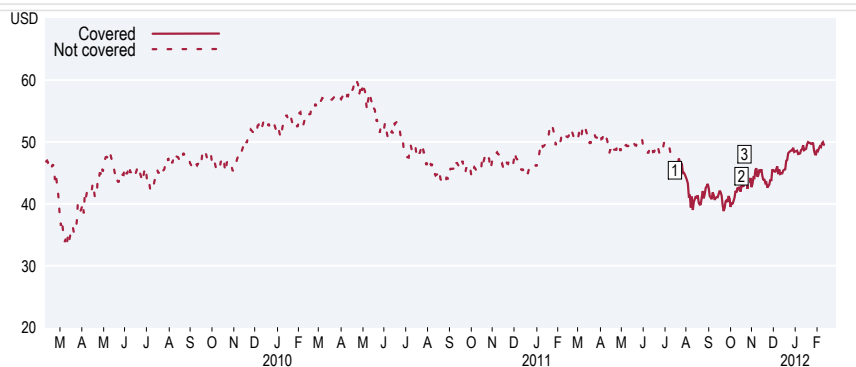
	Date	Rating	Target Price	Closing Price
7	14-Oct-10	1H	*58.00	45.52
8	28-Oct-10	1H	*56.00	45.64
9	8-Nov-10	1H	*58.00	48.33
10	28-Jan-11	1H	*62.00	49.48
11	28-Apr-11	1H	*64.00	49.25
12	28-Jul-11	1H	*62.00	45.02

	Date	Rating	Target Price	Closing Price
13	8-Oct-11	Stock rating system changed		
14	8-Oct-11	*1	62.00	41.00
15	18-Oct-11	1	*59.00	42.88
16	27-Oct-11	1	*56.00	43.79
17	26-Jan-12	1	*59.00	49.89

Rating/target price changes above reflect Eastern Standard Time

# Raytheon Co. (RTN) Ratings and Target Price History Best Ideas Research Relative Call (3 Month)

Analyst: Jason Gursky  
Covered since July 15 2010



	Date	Rating	Target Price	Closing Price
1	15-Jul-11	*ADD MP	-	46.05

\* Indicates change

	Date	Rating	Target Price	Closing Price
2	18-Oct-11	*REM MP	-	42.88

	Date	Rating	Target Price	Closing Price
3	21-Oct-11	*ADD MP	-	43.97

Rating/target price changes above reflect Eastern Standard Time

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