



# MFIF

Minutemen Fixed Income Fund

## Lockheed Martin (NYSE: LMT)

Analyst: Joseph Mulherin

We recommend and marketweight position on Lockheed Martin's 1.85% senior unsecured notes. Lockheed Martin (LMT) maintains a leading market position in the Aerospace and Defense sector, and due to the strength of their F-35 program, newly completed F-16 facility, and strong backlog growth, they will likely maintain that position into the near-future. However, investor expectations already appreciate these facts, and LMT faces certain downside risks which must factor into the purchase of this security. We believe that uncertainties regarding the stability of LMT's margins following the end of CARES act funding, paired with our expectations that LMT's space program will lose market share, could materially impact results enough to call their 2030 note's position as a safe-haven asset into question. With that being said, we believe that LMT's 2030 notes are appropriately priced – still tighter than all industry rivals. LMT's '30s are currently trading at a YTW of 1.23%, and given the current 5-year forward inflation expectation rate of 1.76%, LMT's 2030 notes provide a real yield of -0.53%, leaving little room for price appreciation: investors seeking high returns may want to turn elsewhere.

Figure 1: Capitalization Table

Lockheed Martin (LMT)							
LTM EBITDA, Leverage	9,966	1.3x					
2020E EBITDA, Leverage	10,075	1.3x					
Debt Outstanding (USD in Millions)							
Type	Amount O/S	Maturity	Coupon	Price	YTW	Market Value	Acc. Interest
Senior Unsecured Notes of 2021	500	9/15/2021	3.55%	102.7%	0.12%	513.7	0.51
Senior Unsecured Notes of 2022	4	1/15/2022	9.00%	108.6%	1.62%	4.5	2.88
Senior Unsecured Notes of 2022	2	2/1/2022	9.13%	108.9%	1.74%	2.3	2.51
Senior Unsecured Notes of 2023	500	1/15/2023	3.10%	105.7%	0.27%	528.4	0.99
Senior Unsecured Notes of 2023	3	1/15/2023	8.38%	114.1%	1.77%	3.6	2.68
Senior Unsecured Notes of 2023	115	9/15/2023	7.00%	115.1%	1.56%	132.7	1.07
Senior Unsecured Notes of 2024	168	6/15/2024	8.38%	124.0%	1.50%	207.7	3.37
Senior Unsecured Notes of 2025	750	3/1/2025	2.90%	109.6%	0.51%	821.9	0.56
Senior Unsecured Notes of 2025	142	6/15/2025	7.63%	126.2%	1.68%	179.4	3.07
Senior Unsecured Notes of 2026	2,000	1/15/2026	3.55%	114.0%	0.66%	2,280.5	1.13
Senior Unsecured Notes of 2026	168	5/1/2026	7.75%	131.8%	1.65%	222.0	0.19
Senior Unsecured Notes of 2029	183	12/1/2029	8.50%	148.5%	2.49%	271.8	3.75
Senior Unsecured Notes of 2030	400	6/15/2030	1.85%	105.5%	1.23%	421.9	0.87
Senior Unsecured Notes of 2035	500	3/1/2035	3.60%	122.5%	1.75%	612.7	0.69
Senior Unsecured Notes of 2036	32	5/1/2036	7.20%	154.7%	2.82%	49.5	0.18
Senior Unsecured Notes of 2036	500	5/15/2036	4.50%	132.0%	2.02%	659.8	2.19
Senior Unsecured Notes of 2036	554	9/1/2036	6.15%	150.6%	2.31%	833.9	1.18
Senior Unsecured Notes of 2039	196	11/15/2039	5.50%	139.9%	2.78%	274.8	2.67
Senior Unsecured Notes of 2040	351	6/1/2040	5.72%	148.0%	2.58%	519.5	2.53
Senior Unsecured Notes of 2041	239	9/15/2041	4.85%	134.4%	2.68%	320.8	0.74
Senior Unsecured Notes of 2042	1,327	12/15/2042	4.07%	128.2%	2.41%	1,702.1	1.64
Senior Unsecured Notes of 2042	9	12/15/2042	4.07%	127.8%	2.44%	11.5	1.64
Senior Unsecured Notes of 2042	9	12/15/2042	4.07%	127.8%	2.44%	11.5	1.64
Senior Unsecured Notes of 2045	1,000	3/1/2045	3.80%	123.4%	2.49%	1,233.7	0.73
Senior Unsecured Notes of 2046	1,326	5/15/2046	4.70%	139.6%	2.55%	1,852.2	2.28
Senior Unsecured Notes of 2050	750	6/15/2050	2.80%	108.1%	2.41%	810.5	1.32
Senior Unsecured Notes of 2052	1,578	9/15/2052	4.09%	132.8%	2.56%	2,095.6	0.62
Senior Unsecured Notes of 2052	1	9/15/2052	4.09%	133.1%	2.55%	1.3	0.62
Senior Unsecured Notes of 2052	1	9/15/2052	4.09%	133.1%	2.55%	1.3	0.62
<b>Total Debt</b>	<b>13,309</b>					<b>16,581</b>	
(+) Market Capitalization	108,580					108,580	
(-) Cash	-3,585					-3,585	
(-) Preferred Stock	0					0	
(-) Noncontrolling Interests	-33					-33	
<b>Enterprise Value</b>	<b>121,888</b>					<b>125,161</b>	
<b>Liquidity</b>							
Revolver Commitments	2,500						
Revolver Outstanding	0						
Revolver Availability	2,500						
(+) Cash	3,585						
<b>Total Liquidity</b>	<b>6,085</b>						

### Security Data

Bond Maturity: 06/15/2030

Rating: A3/A-

Tranche: Senior Unsecured

Price: \$105.48

YTW: 1.23%

Mty. Type: Callable

Coupon: 1.85%

Z-Spread: 51.5 bps

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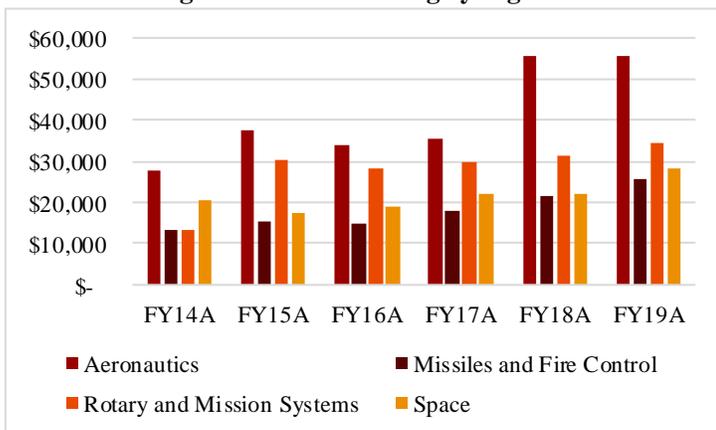
**Company Overview**

LMT is an American Aerospace & Defense company, which has led the industry in research, design, manufacturing, and sustainment of cutting-edge military hardware for decades. Founded in 1912, LMT has led the A&D industry for over a century. Its Aeronautics segment offers both manned and unmanned combat and mobility aircraft, as well as supplementary technologies. Missiles and Fire Control Systems provides a range of products and services ranging from air-to-ground precision strike weapon systems and tactical missiles to engineering and integration support services. Rotary and Mission Systems segment has two main operational priorities: to provide military-grade helicopters and nautical combat vehicles, and to provide a wide range of mission services such as C4ISR capabilities and cybersecurity. Finally, Space Systems provides long-range missile products and produces satellites, with a technological emphasis on the integration of space and ground-based technologies for intelligence gathering.

**F-35 will Drive Cash Flow Generation**

The largest single revenue driver for LMT is their F-35 – the next generation American-made fighter jet. The company has sold a total of ~500 F-35 aircraft to the United States and its allies, at an average per-unit price of ~\$79M, representing ~\$36B in sales to date. Production of the F-35 has ramped significantly since the first unit was produced in 2011, and sales are estimated to reach ~140 aircraft in 2021 and ~170 aircraft in 2022, representing ~\$11.1B and ~\$13.4B in revenue in each year respectively. At 170 units/year, LMT will be producing F-35's until ~2031 in order to fill DoD's order of 2,456 F-35's for all branches of the U.S. military. Sustainment revenue from the F-35 fleet will reach \$3B for FY20E, and based on guidance, as well as future F-35 sales estimates, we believe F-35 sustainment will provide LMT with ~\$6B in reliable annual revenue, at higher margins than initial production (roughly ~13%, as opposed to a historical ~9% production margin).

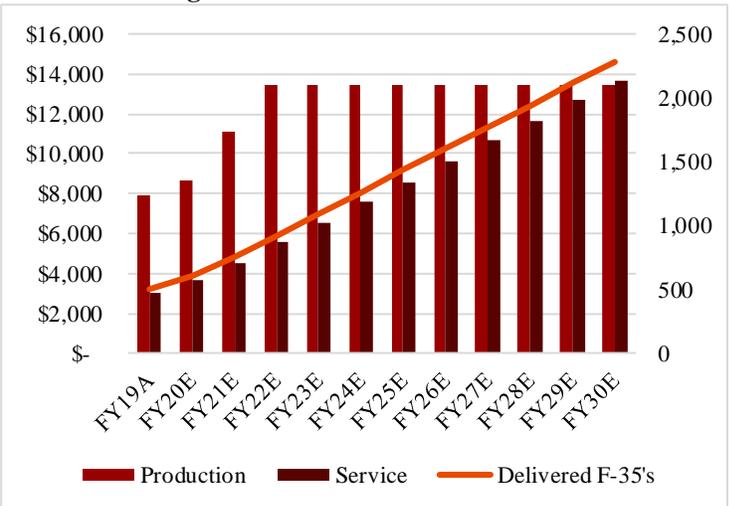
**Figure 3: Order Backlog by Segment**



**Management**

James D. Taiclet is LMT's President and CEO. Prior to being assigned to these roles in June 2020, Taiclet was chairman and CEO of American Tower Corporation, where he grew the company's market cap from ~\$2B to over \$100B, driving strong international growth. As CEO of LMT, Taiclet has expressed interest in pursuing technological partnerships or acquisitions to overhaul the existing DoD network infrastructure. Additionally, Taiclet has placed great emphasis on product sustainment as a dependable source of long-term earnings streams.

**Figure 2: Estimated F-35 Revenue**

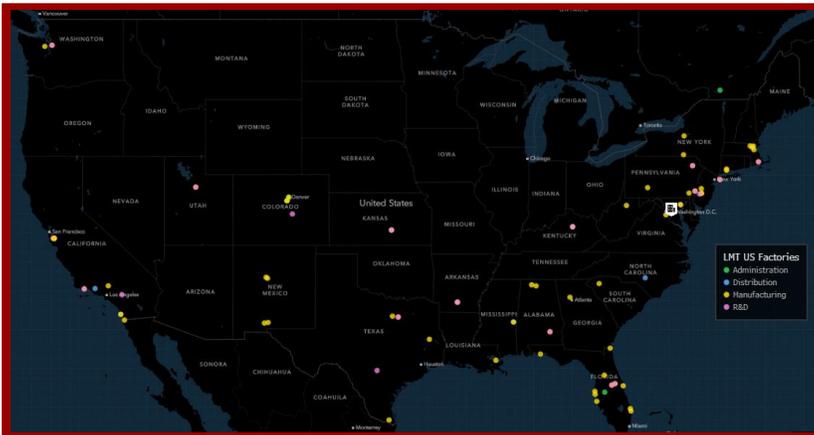


Source: Company Filings, 1Q20-3Q20 Earnings Calls

**International F-16 Demand, Backlog Strength**

LMT has ramped production of the F-16 – once thought to be ready for retirement. The F-16 is still the NATO standard fighter jet, and as such there is still strong international demand for the plane. To accommodate this, LMT opened a new F-16 production facility in Greenville, South Carolina that will increase production by ~50%. The largest single deal yet announced was a \$62B contract with DoD to produce an unspecified number of F-16's for sale to American allies, potentially including Bulgaria, Slovakia, Morocco, and the Kingdom of Bahrain. Additionally, at least 66 are being delivered to Taiwan, a move which earned LMT, amongst other American arms manufacturers, a sanction from China. Despite that headwind, we believe F-16 production and sustainment, paired with F-35 revenues, will continue to propel Aeronautics growth forward by ~\$1.7B y/y. Additionally, F-16 production margins are ~400bps wide of F-35 margins due to the maturity of the produce along with economies of scale – we believe this will help Aeronautics expand margins back to historical levels – around 12% – once production is fully initiated and COVID related contraction is restored around ~FY24E.

Figure 4: Map of LMT U.S. Facility Dispersion



Source: Bloomberg

**Idiosyncratic Supply Chain Disruptions from Political Hedging**

Lockheed Martin employs a successful strategy of political risk hedging by spreading their ~110,000 employees throughout various U.S. electoral districts. This encourages lawmakers from those districts to approve budgetary appropriation increases for LMT to spur job growth within their constituency. The result of this strategy can be observed in Figure 4, visualizing the ~375 facilities LMT operates throughout the United States.

This dissemination of employees results in an even wider supply chain: LMT works with ~16,000 distinct active suppliers from all 50 U.S. states. In normal times, this strategy works well for the company, but COVID-19 has placed significant strain on LMT's supply chain. Many LMT suppliers have been forced to reduce warehouse staff or otherwise disrupt their operations because of the virus. To remedy this, congress approved a ~\$3B allocation to LMT under the CARES act, which has been allotted to the company since March 2020. This has propped up LMT's margins – we estimate that without the CARES act allocation, LMT's gross margin would have contracted ~300 bps from 2Q20A-4Q20E.

This will be a significant risk for LMT going into 2021, as CARES act funding for government contractors expires on 12/11/2020. Because of the political unpopularity of fueling the margins of the A&D primes, paired with what now looks like a split legislature, there is a significant chance that LMT would not receive an allocation in a second round of fiscal stimulus. Accordingly, we estimate that LMT's operating margin will contract ~160bps in FY21E, compounding LMT's ~190bps margin contraction in FY20E *with* stimulus.

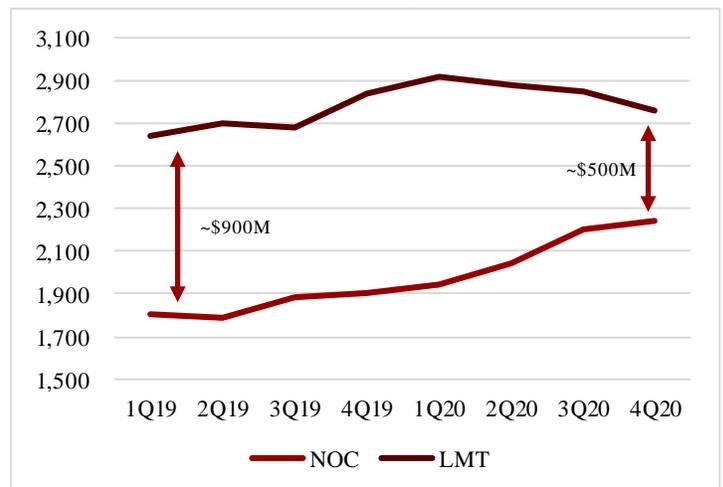
**Risks**

- In the event of a sharper economic turndown from the pandemic, investors may seek refuge from risk in LMT notes, driving their spread tighter.
- If F-35 demand were to drop for any reason, LMT would be seriously affected: they currently source ~25% of their revenue from production and servicing of the F-35.
- If stimulus funding for FY21 matches that which LMT received in FY20, their margins will likely remain flat and their cash flow profile would grow rather than shrink.

**Losing Space Contracts; Contracting Margins**

Despite being historical industry leaders in private-sector space technology, LMT has fallen behind in recent years and is losing market share to companies like Northrop Grumman (NOC) and SpaceX. Despite being the prime contractor for NASA's Hubble space telescope, LMT lost the bid to construct the James Webb space telescope – a ~\$10B project – to NOC. While NOC has managed to grow space revenues at ~3.4% q/q for the last two years, LMT has managed only ~0.7% q/q growth. Over the same period, LMT's space sector operating margin has contracted by ~400bps, owing to operational failure in several key projects. LMT's new LM 2100 satellite bus platform, of which they have built three, is much more expensive for the company to produce than they had predicted, resulting in a cumulative loss from the three contracts of ~\$410M and contributing in large part to space segment margin contraction of ~400 bps since FY18A. Their hybrid xenon propulsion system and advanced composite solar arrays are not cost efficient, and as a result we believe LMT will continue to lose space contracts to more viable competitors.

Figure 5: LMT Losing Space Market Share

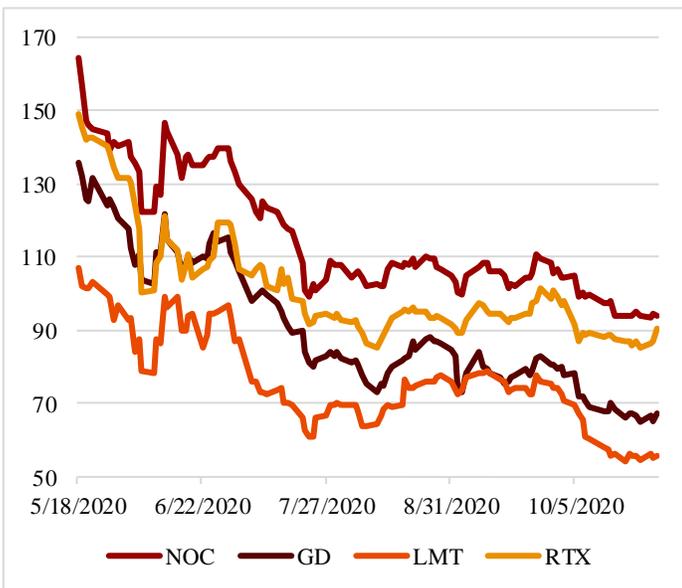


Source: Company filings

**Relative Value**

LMT's 2030 notes are currently trading ~11bps tight of their nearest comp, General Dynamics (GD). We believe this is fully justified given LMT's superior credit metrics in every category. Were A&D credits not safe-haven assets, we would expect this spread to widen out to Given that LMT's Debt/EBITDA is ~1.6 turns lower than NOC, who generates ~\$2.3B less in FCF, the ~40bps gap in spread between the two companies is mostly justified. Though we expect to see that gap tighten given our optimistic outlook for NOC, LMT's relative performance will play no role in that correction. Our outlook for LMT is mostly optimistic, and so relative to its closest competitors we believe it should remain in its leading position.

**Figure 7: Comparable Option-Adjusted Spreads**



Source: Bloomberg

**Investment Thesis**

LMT's 1.85% 2030 notes are only a viable investment as a hold-to-maturity, for two reasons. First, on a fundamental level, we do not believe the notes have any more room to tighten, given their position relative to their competitors and the fact that they are trading ~44bps tight of the Bloomberg Barclays A-rated corporate index, which is currently at 1.67%. Second, interest rate risk is heightened on the 30's because of their exceptionally low coupon rate. If the Fed raises rates to 3% in the next decade before these notes mature, they will lose ~25% of their free market value. Therefore, we recommend these notes to any investor who has need of credit which they can be highly confident in, but not for those who have no room in their portfolio for notes with exceptionally low yield.

**Figure 6: Comparable Company Metrics**

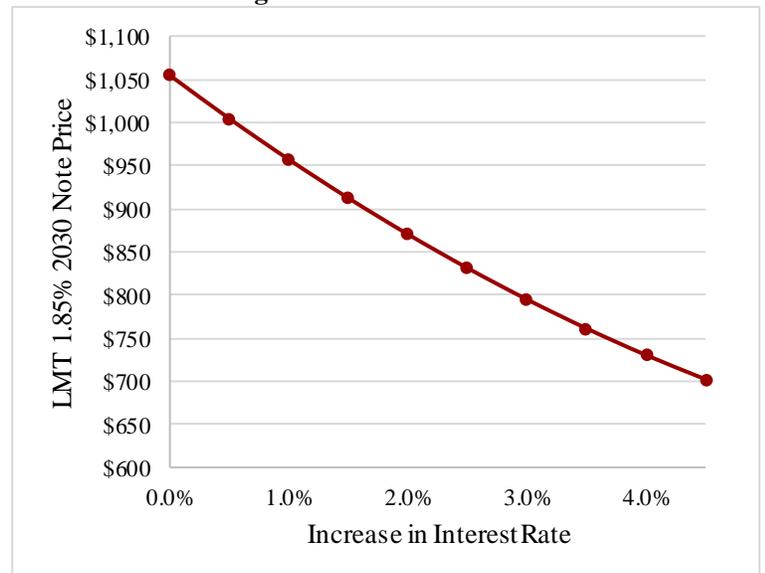
Comps (USD in Millions)	LMT	GD	NOC	RTX
Market Cap	108,580	40,013	49,006	91,339
Debt	13,309	15,970	16,057	34,473
Cash	3,585	2,300	4,178	6,975
Net Debt	9,724	13,670	11,879	27,498
Enterprise Value	118,303	53,683	60,885	118,837
Revenue (LTM)	64,244	39,350	35,308	77,046
EBITDA (LTM)	9,966	5,245	5,140	5,299
Debt/EBITDA (LTM)	1.34x	3.05x	2.93x	6.51x
Net Debt/EBITDA (LTM)	0.98x	2.61x	2.31x	5.19x
EBITDA Margin (LTM)	15.5%	14.7%	16.3%	19.2%
EBITDA/Interest (LTM)	16.6x	12.2x	9.2x	9.2x
FCF (LTM)	6,888	2,313	3,896	3,305
<b>Individual Security Comps</b>				
Rating	A3/A-	A2/A	Baa2/BBB	Baa1/BBB+
Coupon	1.85%	3.63%	4.40%	2.25%
Maturity	6/15/2030	4/1/2030	5/1/2030	7/1/2030
Price	105.5	119.0	123.0	104.5
YTW	1.23%	1.41%	1.70%	1.72%
Z-Spread	55.3 bps	64.6 bps	94.5 bps	92.9 bps
OAS	55.5 bps	66.0 bps	96.1 bps	93.1 bps
Next Call Date	3/15/2030	1/1/2030	2/1/2030	4/1/2030
OAS/Turn of Leverage	41.6 bps	21.7 bps	32.8 bps	14.3 bps

Source: Bloomberg, Company Filings

**Desirability as a Safe-Haven Asset**

LMT is, along with the other defense primes, a heavily-government sponsored business. There is almost no scenario in which LMT would default on their debt obligations, given their industry-leading fiscal conservatism, strong order demand and backlog, and political hedging strategy. The market is well aware of these facts and has priced the 2030's accordingly – at their current 1.23% YTW, an investment in LMT's notes would provide a real yield of -0.53%, given forward inflation expectations of ~1.76%. Ultimately, we believe that LMT's 2030 notes are trading at the lower bound of where they should. Therefore, investors looking to hedge against macro risk, and who can stomach the -0.53% real yield should consider investing in this security.

**Figure 8: Interest Rate Risk**



Source: Bloomberg

Figure 9: Summary Model

<b>Lockheed Martin (LMT)</b>										
Fiscal Year	FY17A	FY18A	FY19A	1Q20A	2Q20A	3Q20A	4Q20E	FY20E	FY21E	FY22E
EOP Date	12/31/2017	12/31/2018	12/31/2019	3/29/2020	6/28/2020	9/27/2020	12/31/2020	12/31/2020	12/31/2021	12/31/2022
<b>Income Statement</b>										
<b>Net sales</b>										
<i>Aeronautics</i>	19,410	21,242	23,693	6,369	6,503	6,680	6,747	26,299	27,669	28,792
<i>Missiles and Fire Control</i>	7,282	8,462	10,131	2,619	2,801	2,971	3,016	11,407	12,521	13,290
<i>Rotary and Mission Systems</i>	13,663	14,250	15,128	3,746	4,039	3,998	4,038	15,821	16,560	17,232
<i>Space</i>	9,605	9,808	10,860	2,917	2,877	2,846	2,860	11,500	11,585	11,818
Total net sales	49,960	53,762	59,812	15,651	16,220	16,495	16,661	65,027	68,335	71,132
<b>Cost of sales</b>										
Products	(38,417)	(40,293)	(44,589)	(11,742)	(12,092)	(12,370)	(12,899)	(49,103)	(52,539)	(54,085)
Services	(6,673)	(7,738)	(8,731)	(2,213)	(2,339)	(2,363)	(2,498)	(9,413)	(10,175)	(10,474)
Severance and restructuring	-	(96)	-	-	-	-	-	-	-	-
Other unallocated, net	1,501	1,639	1,875	395	424	374	438	1,631	1,753	1,753
Total cost of sales	(43,589)	(46,488)	(51,445)	(13,560)	(14,007)	(14,359)	(14,958)	(56,884)	(60,961)	(62,806)
Gross profit	6,371	7,274	8,367	2,091	2,213	2,136	1,702	8,142	7,374	8,326
Stock based compensation	(158)	(173)	(189)	(42)	(73)	(67)	(31)	(213)	(213)	(213)
Unallocated operating items	1,810	1,630	2,160	439	369	452	489	1,749	1,954	1,954
<b>Operating profit</b>										
<i>Aeronautics</i>	2,176	2,272	2,521	672	739	705	493	2,609	2,194	2,571
<i>Missiles and Fire Control</i>	1,034	1,248	1,441	396	370	405	320	1,491	1,406	1,625
<i>Rotary and Mission Systems</i>	902	1,302	1,421	376	429	404	275	1,484	1,230	1,452
<i>Space</i>	980	1,055	1,191	281	252	248	177	958	791	925
Total operating profit	6,744	7,334	8,545	2,122	2,086	2,147	1,722	8,077	7,362	8,314
Interest expense	(651)	(668)	(653)	(148)	(149)	(145)	(127)	(569)	(546)	(537)
Other non-operating expense, net	(847)	(828)	(651)	56	25	54	-	135	-	-
Earnings before taxes	5,246	5,838	7,241	2,030	1,962	2,056	1,594	7,642	6,816	7,777
Income tax	(3,356)	(792)	(1,011)	(313)	(336)	(303)	(261)	(1,213)	(1,118)	(1,275)
Earnings from continued operations	1,890	5,046	6,230	1,717	1,626	1,753	1,333	6,429	5,698	6,502
Earnings from discontinued operations	73	-	-	-	-	(55)	-	(55)	-	-
Net earnings	1,963	5,046	6,230	1,717	1,626	1,698	1,333	6,374	5,698	6,502
<b>Revenue Growth</b>										
Aeronautics	9.2%	9.4%	11.5%	-0.2%	2.1%	2.7%	1.0%	11.0%	5.2%	4.1%
Missiles and Fire Control	10.2%	16.2%	19.7%	-5.4%	6.9%	6.1%	1.5%	12.6%	9.8%	6.1%
Rotary and Mission Systems	1.5%	4.3%	6.2%	-3.7%	7.8%	-1.0%	1.0%	4.6%	4.7%	4.1%
Space	2.1%	2.1%	10.7%	2.7%	-1.4%	-1.1%	0.5%	5.9%	0.7%	2.0%
Total Revenue Growth	12.8%	13.5%	14.0%	13.4%	13.6%	12.9%	10.2%	12.5%	10.8%	11.7%
<b>Operating Metrics</b>										
Gross Margin	12.8%	13.5%	14.0%	13.4%	13.6%	12.9%	10.2%	12.5%	10.8%	11.7%
Operating Margin	13.5%	13.6%	14.3%	13.6%	12.9%	13.0%	10.3%	12.4%	10.8%	11.7%
Tax Rate	64.0%	13.6%	14.0%	15.4%	17.1%	14.7%	16.4%	15.9%	16.4%	16.4%
<b>EBITDA Reconciliation</b>										
(+) EBIT	6,744	7,334	8,545	2,122	2,086	2,147	1,722	8,077	7,362	8,314
(+) Depreciation and Amortization	1,195	1,161	1,189	301	307	319	285	1,212	1,196	1,286
(+) Stock-Based Compensation	158	173	189	42	73	67	31	213	213	213
EBITDA	8,097	8,668	9,923	2,465	2,466	2,533	2,038	9,502	8,771	9,813
<b>FCFF Reconciliation</b>										
(+) EBIT*(1-Tax)	6,476	3,138	7,311	2,314	2,182	1,880	1,743	8,119	6,539	7,656
(+) Depreciation & Amortization	1,195	1,161	1,189	301	307	319	285	1,212	1,196	1,286
(-) Increase in Working Capital	(17)	(3,094)	(468)	254	48	(259)	94	137	(567)	(344)
(-) Capex	(1,177)	(1,278)	(1,484)	(293)	(343)	(408)	(383)	(1,427)	(1,572)	(1,636)
FCFF	6,477	(73)	6,548	2,576	2,194	1,532	1,740	8,042	5,596	6,962
<b>Credit Metrics</b>										
Debt	14,263	14,104	12,654	12,689	12,674	12,675	13,309	13,309	12,809	12,802
Debt/EBITDA	1.8x	1.6x	1.3x	1.3x	1.3x	1.3x	1.4x	1.4x	1.5x	1.3x
EBITDA/Interest	12.4x	13.0x	15.2x	15.5x	16.1x	16.6x	16.7x	16.7x	16.1x	18.3x

Source: Company Filings