



Preliminary Rating: **HOLD** | Current Price: **\$442.69** | 52-Week Range: **\$324.23 - \$479.99**

EXECUTIVE SUMMARY

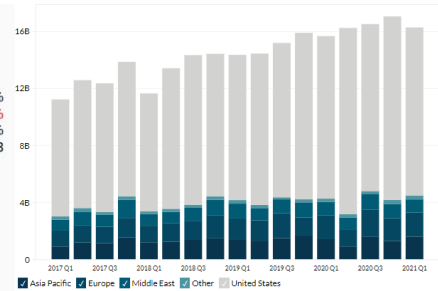
The TCM Industrials Sector team places a preliminary HOLD rating on Lockheed Martin Corporation (LMT). Lockheed Martin is a globally operating American security and aerospace company that designs, develops, and supports advanced technology systems, products, and services for military, civil, and commercial use. Currently, Lockheed Martin comprises 3.3% of the TCM Equity portfolio. The company has a favorable position to grow amid expanding government defense spending worldwide, which complements its directed growth strategy. Its consistently positive free cash flows allow the company to reinvest in its business and return capital to shareholders. Although risks arise from supply chain disruptions and the legal and regulatory industry environment, these factors will not have a material impact on Lockheed Martin’s industry position.

LMT Price Performance



Source: FactSet

LMT Revenue by Region



Source: Business Quant

BUSINESS DESCRIPTION

Lockheed Martin Corporation (LMT; Lockheed) is an American security and aerospace company with worldwide interests. Lockheed Martin engages in the entire production process of advanced technology systems, products, and services. The company has become an industry leader in the aerospace and defense industry; its products are used globally in military, civil, and commercial areas. By revenue, Lockheed is the largest defense contractor in the world.

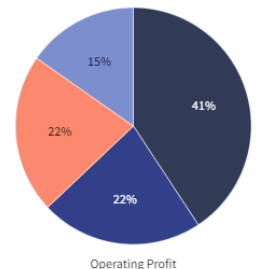
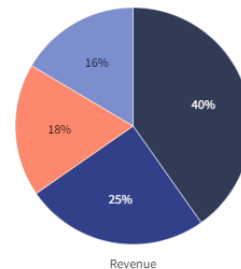
Lockheed operates in four main business segments:

- **Aeronautics:** Products and services include advanced military aircraft, unmanned air vehicles, and related technologies and services. Lockheed’s Aeronautics segment generates the most revenue for the company.
- **Missiles and Fire Control (MFC):** Diverse product portfolio includes air and missile defense systems, logistics, fire control systems, manned and unmanned ground vehicles, energy management solutions, related services, and more.
- **Rotary and Mission Systems (RMS):** Products and services include military and commercial helicopters, surface ships, sea and land-based missile defense systems, radar systems, related services, and more. The RMS business segment generates the second-most revenue for the company.
- **Space:** Products and services include the development and production of satellites, space transportation systems, and defensive systems, along with classified items in support of national security systems.

Lockheed Martin Segment Breakdown

Based on Lockheed Martin’s Q4 FY 2021 ended Dec. 31, 2021

- Aeronautics
- Rotary and Mission Systems
- Missiles and Fire Control
- Space



Revenue percentages do not add to 100% due to rounding

Chart: Matthew Johnston • Source: Lockheed Martin 8-K

Lockheed's products and services have a wide range of defense, civil, and commercial applications. The company has contracts with various entities for the production and sale of its products; its largest customer is the U.S. government. During the most recent fiscal quarter, 72% of Lockheed's net sales came from the U.S. government, 27% came from international governments, and 1% came from U.S. commercial and other customers.

INDUSTRY OVERVIEW

The Aerospace and Defense Industry in the Industrials sector includes manufacturers of civil or military aerospace and defense equipment, parts, or products. This industry covers the manufacture of both commercial and military aircraft, military weapons systems and electronics, satellites and space transportation systems, and related services. Lockheed Martin operates primarily in the manufacture of military products and services.

Defense contractors like Lockheed Martin generate most of their revenue through sales to governments. Sales are typically on a contract basis; governments contract these companies for a fixed term and a fixed price to produce equipment. Lockheed's biggest customer is the U.S. government, which is also the largest defense spender globally by a large margin. The U.S. government prioritizes military R&D throughout periods of wartime and peacetime. Since money is always being funneled into defense, industry leading defense contractors like Lockheed see consistent cash flows year after year.

Porter's Five Forces Analysis (Low)

- **Threat of Substitutes (Low):**
 - Currently there are no foreseen threats of substitutes since most research and development is done primarily through the government which is kept private. In the future there is always the chance that competitors will create more advanced technology that could push Lockheed out of the primary supplier for the U.S. Government.
- **Supplier Power (Low):**
 - Lockheed Martin has partnered with 15,800 suppliers which makes the individual bargaining power of a company low and the potential for large profit margins. The costs of contracts being dictated by the U.S. Government and the large amount of suppliers, means that the lowest cost for materials will be accepted so that revenues can be maximized.
- **Buyer Power (Medium):**
 - The main customer of Lockheed Martin is the U.S. Government and if Lockheed meets the regulations and production requirements for contracts, the buyer power remains. Contracts take many years to complete and if a customer pulls out of the order, it will take even more time for the customer to finalize and complete a contract with a competitor. Since the U.S. Government has the final say in pricing, Lockheed's revenue for the contract relies on the U.S. Government.
- **Threat of New Entrants (Low):**
 - The research and development timeline for new advanced military technology can range from eight to ten years or longer. Throughout the process, there are strict guidelines and protocols that must be followed. Due to the time, expertise, and resources required to create advanced technologies, the threat of new entrants into the industry is low. For a new entrant to become a threat, an extensive amount of time would have to pass. Additionally, new entrants will not be price competitive. Existing companies have grown to a massive scale over decades, resulting in lower costs and the ability to undercut any new entrants.
- **Competitive Rivalry (Medium):**
 - The competitive landscape of the defense industry is distinct from that of other industries because it generally has a low number of competing firms. Lockheed Martin and two other industry leading companies make up 56.7% of the defense industry's market cap, indicating Lockheed's position as a top competitor. Other sizeable competitors still exist; however, only a few companies have the capital and resources required to truly compete on the most advanced, important, and lucrative contracts.

SWOT Analysis

- **Strengths:**
 - Lockheed Martin is an established company with a global presence in more than 50 countries and a solid customer base. It is a force to be reckoned with as it has a massive workforce of over 110,000 employees and 60,000 engineers who are constantly innovating and revolutionizing its business. Being a part of the Aerospace & Defense subsector, Lockheed Martin counts on excellent backing from the U.S. through multiple government contracts. During the Covid-19 pandemic, Lockheed Martin's adaptability was seamless transitioning to remote work within 48 hours of Covid restrictions. In addition to Covid-19 pandemic impacts, Lockheed Martin is prompted for lower sales in 2022 due to smaller defense department spending and changes to its F-35 fighter jet production. In addition, its capital structure is set up to not cut into research and development heavily in times of budget cuts.

Production and plant costs typically get cut first, allowing Lockheed Martin to maintain innovation as its top priority. Finally, Lockheed's consistency leaves no room for judgement on the quality of products.

- **Weaknesses:**

- One of the weaknesses and challenges that Lockheed Martin faces is its reliance on U.S. government spending. 63% of revenue comes directly from the Department of Defense. Additionally, Lockheed's supply chain is substantially backlogged due to its suppliers being late because of interrupted labor hours and quarantine mandates. One weakness with working on fixed-income contracts is that higher inflation can damage future revenue as its higher costs were not projected in its previous negotiations with suppliers.

- **Opportunities:**

- Countries that had little previous interest with Lockheed Martin have increased its interest dramatically in recent months. Specifically, there is renewed interest with the F-35 from Germany, Canada, and Switzerland in recent months. With the current geopolitical tensions between Russia and Ukraine, Lockheed is looking to nearly double Javelin's missile production and increase its demand overall. Additionally, it is looking to expand internationally with partnered allies. It also needs to scale its work productivity better to chip away at its backlog. According to the CEO, it currently takes three years to get a plane to a country if an order is placed today. Lockheed Martin wants to shorten that time frame to two years instead of three. Specifically increased orders from European countries have been seen in recent months as Germany has purchased 35 U.S. F-35 jets to replace its ageing Tornado.

- **Threats:**

- Lockheed Martin's threats are changes in the political environment, such as the trade war between China and the U.S., the impact of Brexit in the European Union, and the ever-growing instability in the middle east. Regulations in government spending also affect Lockheed's short-term. For example, in March, the Pentagon cut its requests by 35% in its next budget. These policy and budget changes impact the overall production for Lockheed Martin.

Company Position & Competitive Advantage

Lockheed Martin is the largest defense contractor in the world by revenue. Its strong strategic relationships, global recognition, high human capital, and elite research and development program allow it to gain a competitive advantage over its peers. Lockheed has continued to invest in its business, including capital expenditures, independent research and development, and selective business acquisitions. Its Free-Cash-Flows allow LMT to enhance shareholder value either by repurchasing shares or distributing quality dividends to its shareholders. Its capital structure is designed to allow for flexibility when budget cuts arise as around one-third of its spending goes to R&D. LMT has established longstanding and inseparable relationships with governments and high-profile private security companies. Its client base is small, but loyal and stable across many countries in recent decades which is the foundation to maintaining consistency. Another reason Lockheed Martin can stay competitive is its massive human capital. Having over 110,000 employees, including 60,000 engineers, allows Lockheed to consistently produce while researching to innovate. The lack of competitive alternatives allows LMT to allow price its product (and raise) without penalty. Lockheed Martin is in a favorable position to remain an industry leader for the foreseeable future. Provided that the company maintains its longstanding relationships, takes advantage of its unique competitive qualities, and capitalizes on strategic opportunities, Lockheed will continue to see success.

TAILWINDS & HEADWINDS

Lockheed Martin has been a successful defense contractor globally for decades. In an industry where most revenues are generated on a contract basis, Lockheed must ensure that it intelligently navigates its market to maintain its position as a go-to contractor for governments worldwide. Specific tailwinds that support Lockheed's continued position as an industry leader include the following:

- **Global Defense Spending Expansion:**

- Lockheed is expected to benefit from increased government defense spending worldwide. With revenues based on contracts, government defense spending outlook is a critical factor that the company must consider in its operations. Lockheed is poised to directly benefit from government spending initiatives like the Omnibus bill, which directly allocates nearly \$500MM towards Lockheed helicopter projects and will also benefit from expected contract renewals. Governments worldwide are increasing its defense spending; China increased its defense budget by 7.1%, and security has been thrust into the spotlight amid geopolitical conflict in Europe.

- **Directed Growth Strategy**

- Lockheed implements a directed growth strategy in its operations to ensure dominance in its market. A large piece of this is capital expenditure; Lockheed has recognized several attractive contract prospects and plans to invest at least \$1.9B into capital expenditures to support its growth and ability to tackle these contracts. Lockheed recognizes that capital expenditures based on actual or anticipated contracts tend to enjoy the highest ROIC, showing that the company is strategically investing to receive the highest possible return for its efforts.

These tailwinds are expected to support Lockheed in the short, medium, and long terms. The company does face risks in its operations that could threaten its success and position as an industry leader if not mitigated:

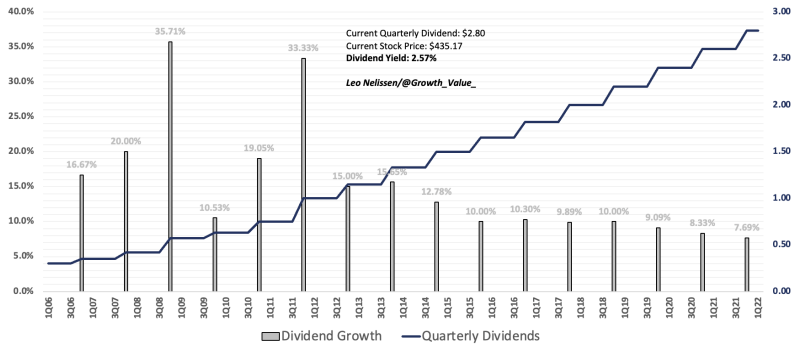
- **Supply Chain Disruptions:**
 - COVID-19 related supply chain disruptions continue to impact businesses with increased difficulty sourcing, ordering, and receiving necessary materials, parts, and products from different regions of the globe. Supply chain disruptions have increased prices across the board, decreasing margins. If Lockheed does not successfully mitigate this risk by maintaining a diverse supplier list and efficient supply chain management, the company will see a negative impact on its future contracts and revenues.
- **Regulatory & Legal Environment:**
 - Since Lockheed is closely involved with governments (including sensitive and classified information), the company is routinely subject to investigations from U.S. government agencies such as the Defense Contract Audit agency and the Defense Contract Management Agency. If improper activities, unclassified costs, or noncompliance with laws are found, the company is subject to penalties, reduced contracts, or withheld payments from the client. These actions could harm Lockheed Martin Corporation's reputation which could affect the available contracts that Lockheed are able to acquire.

The opinion of the TCM Industrials Sector team is that the tailwinds supporting Lockheed in the short, medium, and long terms are sufficient to outweigh the potential downside of the headwinds facing the company. The strategic and intelligent management through ever-changing industry environments proves Lockheed's ability to maintain a competitive advantage over its industry peers.

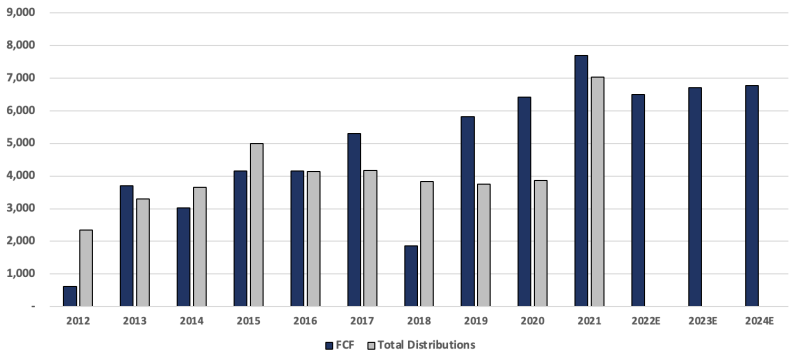
RECOMMENDATION

The TCM Industrials Sector team places a preliminary HOLD rating on Lockheed Martin Corporation (LMT). Lockheed is in a favorable industry position and has tailwinds supporting its success for the foreseeable future. Though it faces supply chain headwinds and a strict legal and regulatory environment that could impact its future position, the TCM Industrials Sector team believes that the tailwinds support a HOLD rating for LMT. Increasing global tensions have caused other nations to rethink their defense strategies, increasing the demand for the aerospace defense industry overall. Inflation and supply chain issues will cause headwinds, but LMT makes a strong case to outperform capital gains in the long run.

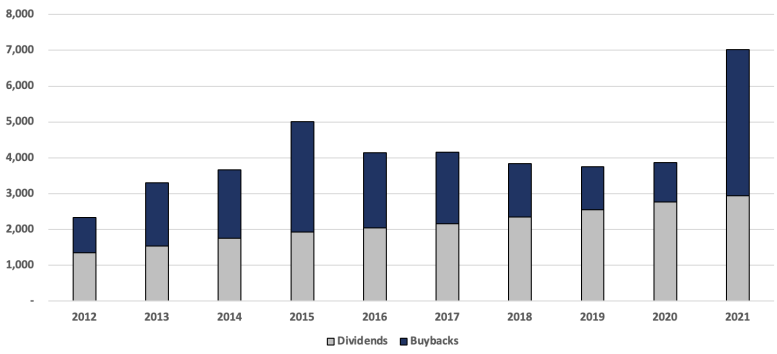
Lockheed Martin Corp. (LMT) Dividend History



Lockheed Martin Corp. (LMT) Total Shareholder Distributions



Lockheed Martin Corp. (LMT) Dividends & Buybacks



APPENDIX

FactSet

Lockheed Martin 10-K

<https://businessquant.com/lockheed-martins-revenue-by-region>

<https://www.investopedia.com/articles/markets/102715/how-lockheed-martin-makes-its-money-lmt.asp>

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