REFINITIV STREETEVENTS

EDITED TRANSCRIPT

LMT.N - Lockheed Martin Corp Intended Acquisition of Aerojet Rocketdyne Holdings Inc - M&A Call

EVENT DATE/TIME: DECEMBER 21, 2020 / 1:30PM GMT

OVERVIEW:

LMT announced that it has entered into a definitive agreement to acquire Aerojet Rocketdyne.

CORPORATE PARTICIPANTS

Frank A. St. John *Lockheed Martin Corporation - COO*

Greg Gardner *Lockheed Martin Corporation - VP of IR*

James D. Taiclet *Lockheed Martin Corporation - President, CEO & Director*

Kenneth R. Possenriede *Lockheed Martin Corporation - CFO*

CONFERENCE CALL PARTICIPANTS

Cai von Rumohr *Cowen and Company, LLC, Research Division - MD & Senior Research Analyst*

Carter Copeland *Melius Research LLC - Founding Partner, President and Research Analyst of Aerospace & Defense*

David Egon Strauss *Barclays Bank PLC, Research Division - Research Analyst*

George D. Shapiro *Shapiro Research - CEO and Managing Partner*

Kristine Tan Liwag *Morgan Stanley, Research Division - Equity Analyst*

Michael James Maugeri *Wolfe Research, LLC - Analyst*

Peter J. Arment *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Robert Alan Stallard *Vertical Research Partners, LLC - Partner*

PRESENTATION

Operator

Good day, and welcome, everyone, to the Lockheed Martin Management Conference Call to discuss the intended acquisition of Aerojet Rocketdyne. Today's call is being recorded.

At this time, for opening remarks and introductions, I would like to turn the call over to Mr. Greg Gardner, Vice President of Investor Relations. Please go ahead, sir.

Greg Gardner - *Lockheed Martin Corporation - VP of IR*

Thank you, John, and good morning. I'd like to welcome everyone to this 30-minute special investor call to discuss the announcement regarding Lockheed Martin's acquisition of Aerojet Rocketdyne. Joining me today on the call are Jim Taiclet, our President and Chief Executive Officer; and Ken Possenriede, our Chief Financial Officer. Also with us today is Frank St. John, our Chief Operating Officer. As most of you know, Frank has previously been the Executive Vice President of our Missiles and Fire Control and Rotary and Mission Systems business areas, and as COO, has been very involved in this transaction.

Statements made in today's call regarding the proposed transaction and expected financial and business impacts that are not historical fact are considered forward-looking statements and are made pursuant to the safe harbor provisions of federal securities law. Actual results may differ materially from those projected in the forward-looking statements. Please see our press release and SEC filings for a description of some of the factors that may cause actual results to differ materially from those in the forward-looking statements.

We have posted charts on our website today that we plan to address during the call to supplement our comments. Please access our website at www.lockheedmartin.com and click on the Investor Relations link to view and follow the charts.

With that, I'd like to turn the call over to Jim

James D. Taiclet - *Lockheed Martin Corporation - President, CEO & Director*

Thanks, Greg. Hello, everyone. And we appreciate you joining us today to discuss our agreement for the combination of Lockheed Martin and Aerojet Rocketdyne.

As described in our press release, Lockheed Martin has signed a definitive agreement to acquire Aerojet Rocketdyne for $51 per share after Aerojet pays a special dividend to their stockholders, representing a transaction value of $4.4 billion, which we plan to fund using a blend of new debt and cash on hand. Our strong balance sheet provides the ability to pursue this opportunity and the flexibility to close on this transaction without having to adjust our balanced cash deployment strategy.

As you may have heard, our 21st Century Warfare Strategy includes enabling growth areas such as hypersonics, tactical missiles, integrated air and missile defense and Space Systems. And we believe this combination represents a compelling value creation opportunity for the customers, shareholders, employees of both our companies.

Aerojet Rocketdyne is a leading provider of propulsion systems across the defense and space landscape, and their capabilities are highly complementary to our portfolio. The acquisition of Aerojet provides an opportunity to fully integrate a key component of our value chain, utilize our combined manufacturing expertise to improve efficiencies and production operations and ultimately position us to be more competitive for our customers.

By harnessing the talent and skill of both Lockheed Martin and Aerojet Rocketdyne employees, we will deliver more innovative and affordable solutions to better meet our customers' most challenging needs. Aerojet is a critical partner across our portfolio already, and this helps position us for even greater growth in hypersonics, missile defense and space, which are key elements of the national defense strategy. And equally important, we believe Lockheed Martin program management manufacturing processes will help enhance Aerojet's ability to excel as a merchant supplier, providing outstanding propulsion products for the entire industry.

I believe it's also important to note that we see this as a key opportunity to reinvest in our business and specifically in the growth areas I just mentioned. Each of our business areas works with Aerojet Rocketdyne products, and we believe that integrating their capabilities across our Lockheed Martin offering will improve manufacturing processes, trade cost savings for our customers and drive efficiencies on behalf of shareholders.

This transaction has been unanimously approved by the Boards of directors of both companies and is expected to close in the second half of 2021. And as a standard in these matters, it's subject to customary closing conditions, including regulatory approval as well as the approval of Aerojet shareholders.

I'll now turn it over to Ken to take you through some of the financial details.

Kenneth R. Possenriede - *Lockheed Martin Corporation - CFO*

Thanks, Jim, and good morning, everyone. Let me start by walking down the elements of the transaction on Chart 4. And as Jim stated, we expect to pay $51 per share to Aerojet Rocketdyne stockholders after taking into account the $5 revocable special dividend that they have planned for March of 2021.

At $51 per share, the total consideration to be paid for Aerojet Rocketdyne's approximately 90 million shares, which I'll add, includes their convertible notes, will come to approximately $4.6 billion. We will then pay off about $315 million of their term loan debt. And considering their projected cash balance, we see a projected transaction value of approximately $4.4 billion at closing.

Turning to Chart 5, we look at an overview of the transaction. Using the transaction value of $4.4 billion, the EBITDA multiple lands at approximately 14.3x, using the 2021 consensus EBITDA estimate. The acquisition was also supported by our robust analysis, which confirmed the long-term economics of this transaction.

As Jim described, we plan to fund this transaction with both cash and debt financing, and we do have a great deal of flexibility in how we finalize the arrangement. Our cash generation remains strong and provides us with an excellent source of funding. We also have debt options available to us at very attractive rates, as you would expect, given our credit rating and the current interest rate environment. We anticipate determining the final funding mix and securing permanent financing, if required, upon completion of the transaction.

We have commented in the past that we do not intend to let cash accumulate on the balance sheet. And as you see with this transaction, we have elected to use some of that cash to reinvest in areas of the corporation that represent the fastest-growing and most profitable parts of our business. The strength of our balance sheet has provided us the opportunity to structure the transaction in this manner, and we will continue to have sufficient cash on hand for our day-to-day operations and our planned cash deployment actions as well as maintaining an attractive leverage profile.

Before I hand it back to Jim, I will close by saying that the economics of the transaction are solid, and we are very pleased both companies have reached this agreement. So back over to Jim.

James D. Taiclet - *Lockheed Martin Corporation - President, CEO & Director*

Thanks, Ken. That brings us to our summary on Chart 6. We view this transaction with Aerojet Rocketdyne is adding complementary products and technologies for the Lockheed Martin portfolio, strengthening our current core capabilities in hypersonics, air and missile defense and space businesses, and bringing to bear, Aerojet's culture of innovation to help support future opportunities.

We believe Aerojet Rocketdyne's customers will also benefit with Lockheed Martin providing engineering and manufacturing support to help them become an even better merchant supplier of propulsion products in the defense and space domains.

We also feel we have an attractive deal structure and a strong business case. Complementary to the financials, this opportunity adds important capabilities to our business, positioning us for continued growth into the future and creating value for our customers and shareholders.

And with that, we're ready to take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And first question is from the line of Kristine Liwag with Morgan Stanley.

Kristine Tan Liwag - *Morgan Stanley, Research Division - Equity Analyst*

Congratulations on this transaction. When you mention that this could provide better value for customers, can you talk more about the cost savings that you could have from this transaction? Or any sort of programs that you think you could win together that you couldn't have done before?

Kenneth R. Possenriede - *Lockheed Martin Corporation - CFO*

Sure.

James D. Taiclet - *Lockheed Martin Corporation - President, CEO & Director*

Kristine, it's Jim, and I'll start off and maybe offer Ken an opportunity to answer as well. I do believe that by bringing the propulsion systems more closely integrated into the overall contract and the overall design of our missile and rocket products will be of value to customers from an efficiency perspective, tighter engineering integration, better production planning, et cetera.

So there's a lot of operational benefits to bringing together the propulsion system with the rest of the integrated product. And then secondly, there's a more, I guess, budgetary respect to this transaction that will benefit our customer base, the end customers, the military services and NASA, among others.

And that is that there's a phenomenon in our industry, as you know, fee on fee, meaning if we have a subcontractor, they'll be charging their fee through us, and we'll be charging our fee through to the end customer. If we can take out one of those fee levels, if you will, the overall product will be more affordable to our end customer.

Now we've accounted for that fee-on-fee effect, if you will, in the valuation of this transaction, fully baked it in. But we also know and believe that we'll have revenue synergies going forward because we'll have more affordable, better integrated and faster to market products. Ken, anything to add?

Kenneth R. Possenriede - *Lockheed Martin Corporation - CFO*

Sure. Yes. So Kristine, welcome to the call. You asked specifically about cost synergies. So as you saw on the chart, as we see it today, and we'll continue working this because we don't anticipate closing this for until late next year. We have estimated about $100 million of annual gross pretax cost synergies, and that's in the first couple of years. And think of that just as a starting point. And think of it about 1/3 of that savings is going to be returned to our customers because of the cost reimbursable nature of the contracts, which is okay.

I mean that's a good value for our customer set. And think about where it's going to come from. We believe from an advanced manufacturing initiative, supply chain management, obviously, administrative costs, you'd normally see an operating public company and some back office savings. We're also looking to gain synergies operationally that may or may not result in cost savings, but we think there's a benefit there. Think of those areas as IRAD, CapEx and some program performance areas, which we're going to have some great commonality with them.

I'll also add that while Aerojet Rocketdyne has capabilities and products that touch on our business areas, they also have a significant amount of their contribution will be to our missiles and fire control portfolio. And we think it's important to note that, that part of this transaction shows that we're reinvesting significantly in our most profitable business area, which is MFC. So thanks for the question, Kristine.

Operator

Next, we'll go to Hunter Keay with Wolfe Research.

Michael James Maugeri - *Wolfe Research, LLC - Analyst*

This is actually Mike Maugeri on for Hunter. So Jim, can you just remind us about your experience with M&A and integration? Any major pitfalls you should avoid with this deal? And maybe that second part is for Frank as well.

James D. Taiclet - *Lockheed Martin Corporation - President, CEO & Director*

Sure, Mike. I've been pretty active in merger and acquisitions, both in the defense space and the telecom digital infrastructure space. So going all the way back to my time at Pratt & Whitney in 2000s, we integrated a number of component repair businesses into our overhaul and repair operations that I was managing at the time, all the way up to and including doing a transaction of about actually this size with Verizon to bringing their digital infrastructure into our portfolio at American Tower about 2, 3 years ago. And we've learned a lot through all those transactions. I'd say it's probably a good 20 or 25 of my experience.

But the first thing in getting the integration right is getting the transaction structure right, making sure that there's real actionable synergies on the cost side, as Ken very clearly described. And also on the revenue side, we think those are there as well. Then it's a matter of really designating single point leadership in the acquiring company, which will be Lockheed Martin, to oversee the full integration of the company. And that will be everything from finance and accounting all the way to delivery and product performance.

And so we'll have subject matter experts leading each of those integrated processes. So I'm sure we've learned a lot also at Lockheed Martin through Sikorsky acquisition, which was just a few years ago. We'll put all those lessons together and avoid the pitfalls. And the pitfalls are literally just not doing the integration, whether it's on a sort of a support or administrative side which needs to be fully integrated just as the operations do.

And I think that with the expertise that I've seen in my last 6 months, especially in engineering, operations, et cetera, we're going to be a better business together than we ever could have been separate, and I'm very confident that we will get through that integration process to deliver that end point.

Operator

And next we'll go to Carter Copeland with Melius Research.

Carter Copeland - *Melius Research LLC - Founding Partner, President and Research Analyst of Aerospace & Defense*

Just a question on the top line. So Aerojet Rocketdyne have been talking about sort of a low-to-mid single-digit growth profile supported by a whole host of programs, many of which are the prime on.

Do you see that being higher under your ownership? And I guess, specifically in hypersonics, they had a couple of handfuls of programs they were working on. You obviously have had several as well. Do you see any acceleration in bringing those programs forward or that technology for in a way that's beneficial?

James D. Taiclet - *Lockheed Martin Corporation - President, CEO & Director*

Carter, I'll just give the headlines. It's Jim and turn it over to Ken. But yes, the product performance area has got real upside for us. In other words, having the engineers are the same organization as they design the integrated propulsion and overall system product, I think, is going to make Lockheed Martin, especially the missiles and fire control and space units, much more effective. We'll also be faster to market. We'll also be more efficient, if you will.

In other words, less expensive to the end customer to deliver that product. So I think on all the key areas of cost, schedule and quality, we're going to be a better operator and a better supplier for our customer base. With that, I'll just let Ken to comment if he'd like.

Kenneth R. Possenriede - *Lockheed Martin Corporation - CFO*

Sure. Carter, yes, we spend a lot of time looking at top line synergies, the cost synergies, obviously, how we were going to integrate Aerojet Rocketdyne into our portfolio. And one thing that we did look at is the combination of the 2 of us, specifically on the top line, we saw some value of putting us together from a revenue synergy standpoint, specifically in missiles and fire control and space.

And even when we discounted some things, depending on where the top line budgets are going to go in light of flattening budgets, we actually saw the Aerojet Rocketdyne piece over time growing faster top line growth than we saw Heritage Lockheed Martin growing. And that's -- our view is that was only going to get better with the combination of the 2 entities.

Operator

Next, we'll go to George Shapiro with Shapiro Research.

George D. Shapiro - *Shapiro Research - CEO and Managing Partner*

My question, Jim, is you have 35% of Aerojet sales from you and maybe if you added ULA, it gets to 40% or so. So it's not clear what the advantage is to buying them? And then second, for Ken, if -- would it be fair to just strike out the 40% of sales and goose up the price you're actually paying for Aerojet since that, as you mentioned, that profit on profit is going to go away? Or is not the right way to look at it?

James D. Taiclet - *Lockheed Martin Corporation - President, CEO & Director*

Yes, George. I mean if you look at the long arc of the defense enterprise, the National Defense enterprise, there's going to have to be more capability delivered, especially in areas like hypersonics and space, integrated air and missile defense is the threat posture that our military and our Department of Defense as spacing evolves. So they're going to have heightened threats in these areas.

Secondly, as Ken pointed out, most likely flattening budgets, lower growth certainly than we may have experienced the last 8 years. So our customer base is going to have to provide more capability, especially in these areas that are pointed out in the National Defense Strategy with a restricted ability to grow their budgets at the same time. And what that's led us to believe is that we need that Lockheed Martin to enrich our platforms with more mission systems content to enable our customers to successfully navigate that future.

And so we feel that bringing them together, acquiring them, again, speeding up time to market with an integrated engineering operation, getting the manufacturability down in operations before we start production as part of the same organization using the same systems and capabilities of people is going to really enhance the attractiveness of Lockheed Martin products in general and going to cut the cost of providing them and increase the margins at the same time. So that combination is really what we're all about. And we think that the acquisition gives us a leapfrog effect to getting to that state of play.

Ken, would you like to add anything?

Kenneth R. Possenriede - *Lockheed Martin Corporation - CFO*

Sure. Just -- George, just as Jim said earlier, when we looked at the fee on fee and to your point, rightly so, we would have to eliminate that once Aerojet Rocketdyne becomes a supplier to us. And we clearly factored that into our valuation. But just to echo what Jim said, we see this as a real significant benefit to our customer. Think of them paying hundreds of millions of dollars less, a result of this arrangement. And again, I'll stress that, that was factored in our evaluation. It's going to make us more competitive which will benefit Lockheed Martin and our customer set in the long run.

And as I mentioned, we look for cost synergies where we may have some overlap, and that's going to help as well. So in net, the fee on fee issue was more than offset by the anticipated benefits that we see associated with this transaction. Just 1 housekeeping matter. On ULA, which last year was roughly, if I recall right, about 10% of Aerojet Rocketdyne sales. We then would be a supplier to ULA. We have an equity interest in ULA, but we don't see any reason why we wouldn't continue to put fee. It will still be a competitive price, of course, continue putting fee on our product as we sell into ULA. So we still see value here in spite of the fee on fee issue.

Operator

Our next question is from Rob Stallard with Vertical Research.

Robert Alan Stallard - *Vertical Research Partners, LLC - Partner*

Jim, a quick question for you. Aerojet obviously supplies to some of your competitors, particularly in hypersonics. How are you going to make them comfortable that this deal isn't changing the competitive landscape?

James D. Taiclet - *Lockheed Martin Corporation - President, CEO & Director*

Well, I think that many of our peer companies in the defense space utilize our business areas already as a merchant supplier to them for components, radar systems, et cetera. So we've already created a -- the company has already created a reputation of being a fair player and an effective supplier to other defense primes.

So we'll try to embellish and enhance that reputation by applying our same integrity standards to the Aerojet Rocketdyne products as we do to the ones we currently sell as a merchant supplier. So I don't really think there's much convincing to do. But we will endeavor to make each of those products from Aerojet Rocketdyne even just better, again, having that integrated engineering and operational capability.

I mean the resources we can bring to bear on a technical problem or an integration of systems is pretty dramatic when you put the 2 companies together. And therefore, I think that our peer group is going to have access, even deeper access to the Lockheed Martin engineering and operational expertise. I think that's a good thing in the end.

Operator

Next, we'll go to David Strauss with Barclays.

David Egon Strauss - *Barclays Bank PLC, Research Division - Research Analyst*

Congrats. Happy Holidays.

James D. Taiclet - *Lockheed Martin Corporation - President, CEO & Director*

You too, David.

David Egon Strauss - *Barclays Bank PLC, Research Division - Research Analyst*

Aerojet's GBSD role. Can you talk about or maybe quantify what that could look like -- what that looks like today and what that could look like I guess, over the near-term and long-term? And then, Jim, maybe 1 for you. Just any sort of color around the regulatory process. I mean how much have you reached out already, done your due diligence with regard to the customer and how they feel about this deal?

James D. Taiclet - *Lockheed Martin Corporation - President, CEO & Director*

Go ahead, Ken, you can start.

Kenneth R. Possenriede - *Lockheed Martin Corporation - CFO*

I would say, Frank, actually, you want to take the GBSD piece?

Frank A. St. John - *Lockheed Martin Corporation - COO*

Sure. I'll start with that. So GBSD is -- got multiple stages and multiple elements of propulsion. And the ultimate prime contractor for GBSD has kind of shared that work between the former Orbital ATK, which is now part of Northrop Grumman and Aerojet Rocketdyne.

And so there's upper stage work on GBSD that is Aerojet Rocketdyne's and that's a -- there's a long-term agreement between the 2 parties there that basically Rocketdyne as the long-term provider of that capability.

It's early days of that program, and they're going through the early development and defining the requirements for that. But Aerojet Rocketdyne is really well positioned for that role.

James D. Taiclet - *Lockheed Martin Corporation - President, CEO & Director*

And as far as the regulatory process, David, what we've concluded is internally and with our outside advisers, is the full complementarity between the Lockheed Martin portfolio and the Aerojet Rocketdyne. In other words, no overlap, so to speak, in the traditional antitrust sense. As far as customers, we haven't been able to reach out to any of them until yesterday afternoon. So I've made those in treaties. We've contacted, I personally about 10 of them, 12 of them at the most senior level, and I know we've gone a lot deeper across our government affairs group, just to give them a heads-up this announcement was coming out, and I'm sure we'll hear from them.

But I do believe that they have the same understanding that I just described to you in general, which is, they're going to be asked to do more in these areas with a flattening budget. And having a more efficient supplier and a more robust supplier, let's say, in uncertain economic times is a positive for the Department of Defense and for NASA. So we haven't had their direct feedback yet, but I do believe they'll see the industrial logic and the common sense as far as what their requirements are going to end up being to deliver for the nation.

So hopefully, we'll have an understanding -- a mutual understanding of the benefits there.

Operator

Our next question is from Cai von Rumohr with Cowen & Company.

Cai von Rumohr - *Cowen and Company, LLC, Research Division - MD & Senior Research Analyst*

Yes. So as you guys obviously recall, Lockheed took a run at Northrop in 1997, and they felt they were going to get it done, but then in came John Hamre in the DoD with a different perspective. So what have you done to sort of check with DoD in terms of what they -- how they actually feel about this? And why do the deal now when you don't know who the incoming folks at DoD are going to be and whether they will favor this or choose to oppose it?

James D. Taiclet - *Lockheed Martin Corporation - President, CEO & Director*

Sure. I think, Cai, there's already an example of how the department viewed a prime contractor in the space domain predominantly in this case, taking in a propulsion supplier, and that was Northrop Orbital ATK deal, which was approved with the caveat that Orbital ATK remain available as a merchant supplier to the rest of the industry.

So our overall expectation is that, that may be the same lens through which this particular transaction is viewed because of the similarities there. And timing predominantly has to do with the availability of asset in the first place, the common sense or the strategic sense of bringing them together and then the ability to come to an agreement on pricing terms. And I would say that whoever is in a particular seat in regulatory review, we can't control that.

But those other areas when we can make them all match and make them all happen in the strategic sense, first and foremost, is there, we're going to make an attempt to make our case to whoever is in that seat.

So I'd say that the timing is driven on our strategy, which is, again, to enrich our platforms with more mission systems content because, I think, that's what the customer is going to need actually for a whole industry to do.

We intend to be a more thorough and deep mission systems supplier as we move forward here, both with internal and maybe even other external investments, and this is part of getting there.

Operator

And next, we'll go to Peter Arment with Baird.

Peter J. Arment - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Just a quick one, Ken. Maybe just on -- could you remind us what you think kind of pro forma leverage will be after transaction? And do you guys anticipate any divestitures or any portfolio shaping?

Kenneth R. Possenriede - *Lockheed Martin Corporation - CFO*

Yes. So Peter, as I mentioned in my opening prepared remarks, notionally, what we've assumed is utilizing $1.5 billion of cash of the balance sheet and then the rest the $3 billion in the debt market. Right now, with attractive rates, it would be a blended roughly 1%, 1.1% yield on that debt, which would be very attractive. But as you know, what we've described going forward, right now, we're still going through our final stage of our long-range plan, and I'll certainly give you a more updated guidance number for 2021 for cash flow. But right now, we see it at greater than equal to $8.1 billion.

I've talked about the CapEx that we require, which is comparable to this year. Obviously, we're going to give a robust dividend for -- in 2021. Share repos of about $1 billion, which means we'll have incremental cash on top of what we will have on cash on hand at the end of this year. And we -- as we stated, we anticipate this thing closing second half of the year. So let's call it, late 2021. And then we'll have our decision to make, and it could be anywhere from what we describe today to the point where perhaps we don't even need to go into the debt market. We'll take it off the balance sheet.

And I'll just remind everybody, even if we did that, we're still committed to internally investing in our corporation. We're committed to looking at other inorganic opportunities. I'm not sure there's nothing on the horizon, but not sure there's -- we're done. And then obviously, for the folks on the phone, our shareholders, we're committed to a robust share buyback program and a healthy dividend. And I think we could do all of that with doing this deal regardless of how much we go into the debt market or take off the -- off our balance sheet from a cash standpoint.

In terms of leverage, we think we're in a great spot. We'll continue looking at other opportunities and where it makes sense we'll go into the market into the debt market to borrow. And it's great to be able to do it opportunistically rather than when you have to. So we feel we're in a good spot there.

Greg Gardner - *Lockheed Martin Corporation - VP of IR*

John, this is Greg. I think we've come to the top of the hour. So I will turn the call back over to Jim for final thoughts.

James D. Taiclet - *Lockheed Martin Corporation - President, CEO & Director*

Okay. Great. Of course. Thanks, everybody, again, for joining us today. As you could tell, we're very excited about this announcement, and we look forward to bringing this important combination to fruition. I hope all of you enjoy the holidays, and I wish everyone a Happy New Year, and we'll be speaking again with you soon on our next earnings call in January. So take care, everybody. Happy Holidays.

Operator

Ladies and gentlemen, that does conclude your conference for today. Thank you for your participation. You may now disconnect.
