



NATIONAL SECURITY

The Trump Defense Budget – And How It Compares To The Last Obama Budget

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Reflections On The DoD's Budget Request

With the release of the FY2019 President's Budget Request, the defense community gets its first real look at President Trump's policy priorities, indicated by the spending outlined in his budget request. We note increased budgets overall, but winners and losers emerge.



Trump's budget is higher by \$341B over FY19-21 compared to the same period under President Obama's FY17 request, signaling the Trump Administration's clear commitment to shoring up U.S. defense capabilities after 5 years of capped defense budgets under sequestration that eroded U.S. national security capabilities and defense readiness. The Trump Administration is prioritizing key missile defense interceptors like the PAC-3 MSE and SM-3 as well as nuclear deterrent platforms including submarines and Trident II. The Administration is also keeping existing F/A-18 and P-8A manufacturing lines open longer than previously expected, and plussing up Classified defense R&D spending by over 10%.

Relatively lower priority areas are signaled by decrements. The Trump Administration is lowering total defense aircraft platform procurement quantities by 46 units over Obama's FY17 budget request. Airlift & tanker quantities decrease by 21%, manned surveillance quantities decrease by 30%, and helicopter quantities decrease by 20%.

While there is a long way to go between a President's Budget Request and Congressional appropriations, and some budget line items will morph and change in the process, the Trump Administration is sending clear policy signals of what capabilities it believes are important to support U.S. national security in the current geopolitical climate.

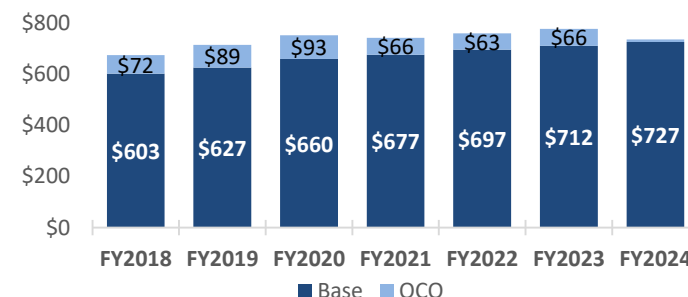
Lastly, we sound a cautionary note that budget requests and actual outlays can be very different, and often increased budgets take several years to translate into increased outlays. Thus it will be important to keep an eye not only on upcoming Congressional budget debate but also the industrial base's ability to absorb the coming defense spending increases.

- Jay Wynn, Managing Director

A Look at the Numbers

President Donald Trump's \$716 billion request for national security programs would provide funding for new warplanes, ships, additional troops, and create a military service prepared for great power competition.

Proposed DoD Budget Caps (\$B)



SOURCE: White House, DoD

Looking Ahead to Fiscal Year 2019

What events are currently on our radar that could significantly impact the budget approved by Congress for the U.S. military?

Geopolitical Events & Turmoil:

- Increased conflict in current theaters of operation
- New conflict arises against Israel and Iran
- U.S. increases, or decreases, the number of deployed troops in Middle East & North Africa
- North Korea offensively strikes South Korea

U.S. Economic Performance:

- Trillion-dollar deficits spook Congress into a renewed focus on a balanced budget amendment
- U.S. GDP growth exceeds 3% annual rate and defense budget grows larger than FY19 PBR plan



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Aerospace, defense and government services primes
Tier 2 and Tier 3 suppliers & small/midmarket svc firms
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EXPERIENCE

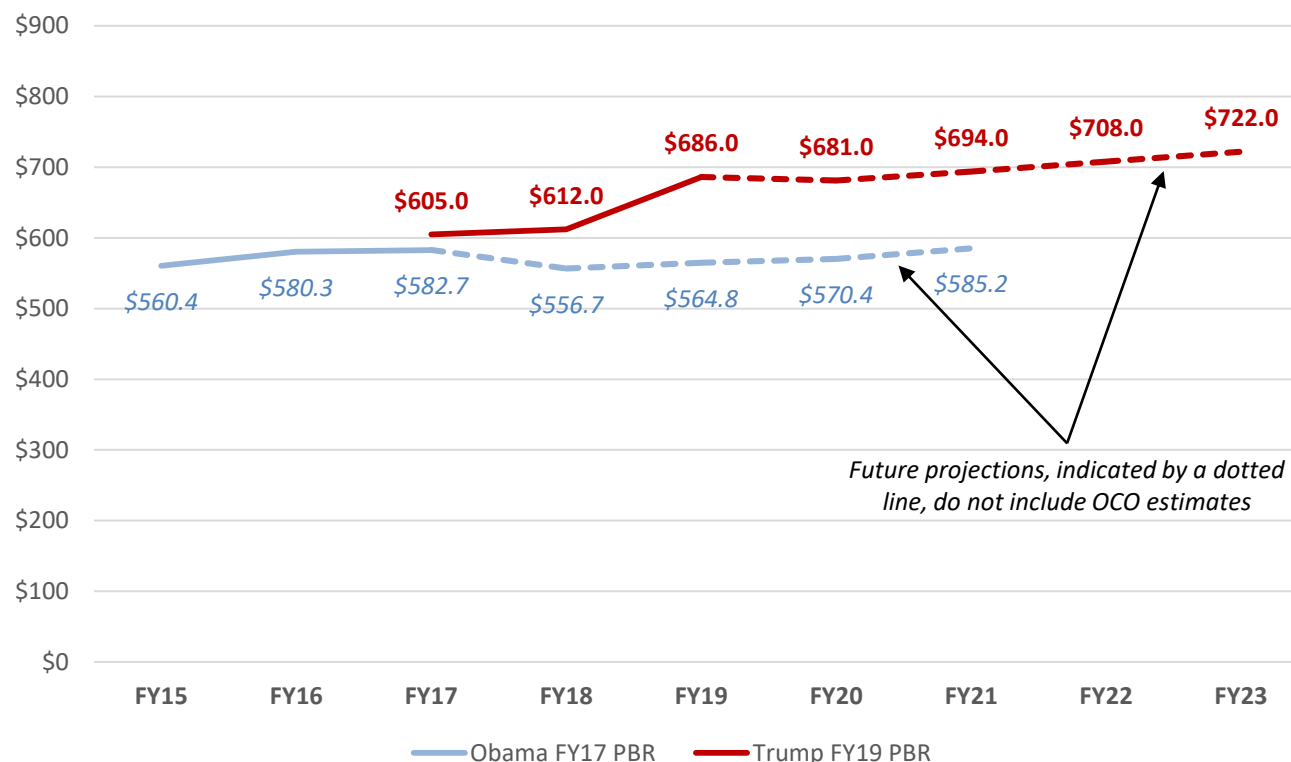
Advisors to CEOs, boards, and leading investors in ADG
100+ strategy engagements
100+ transactions worth \$10B+ in total enterprise value
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Deep domain knowledge across ADG and all subsectors
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- ❑ To understand the impact that President Trump might have on the defense industry, Fairmont reviewed his first full budget request versus the true “last” budget request under President Obama
 - President Trump’s first request was the FY2019 President’s Budget Request (PBR) that was released by the Office of Management and Budget on February 12th 2018
 - Obama’s last budget request that reflected his priorities was FY2017 because the FY2018 request effectively covered the year of an administrative and political transition
- ❑ Between FY19-FY21, President Trump’s request includes \$2.1 trillion of discretionary defense funding versus \$1.7 trillion for the same period under Obama

DoD Discretionary Budget Authority Under Presidents Obama & Trump (\$ Billion)



Considering the strong suggestions candidate Trump made about his priority of national security, the FY2018 request underwhelmed many political and industry leaders.

Courtesy of the recent bipartisan increase in spending caps, the FY19 request includes +\$341B of additional DoD discretionary funding FY19-21 versus President Obama’s FY17 request.

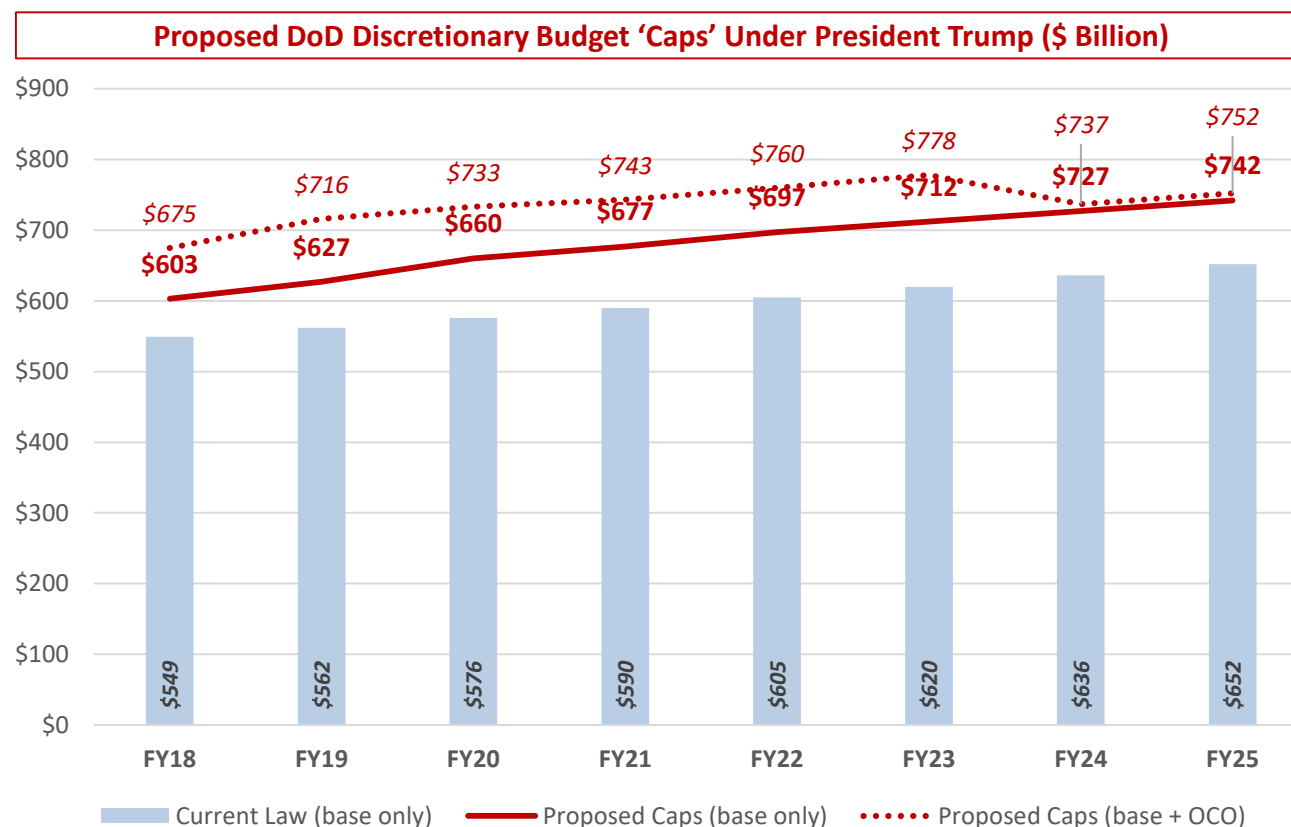
This +20% increase will benefit the nation’s industrial base.

- ❑ A critical barrier to increasing the DoD budget since FY2011 has been the Budget Control Act and its spending caps, or ceilings, that triggered mandatory cuts if exceeded
- ❑ However, President Trump's FY2019 request includes increased spending caps that would allow the base budget to increase each year with no risk of sequestration
 - Including the proposed caps to Overseas Contingency Operations (OCO) funding, the FY2019 PBR would allow DoD's budget to be +26% greater than current law would allow between FY2019-2023

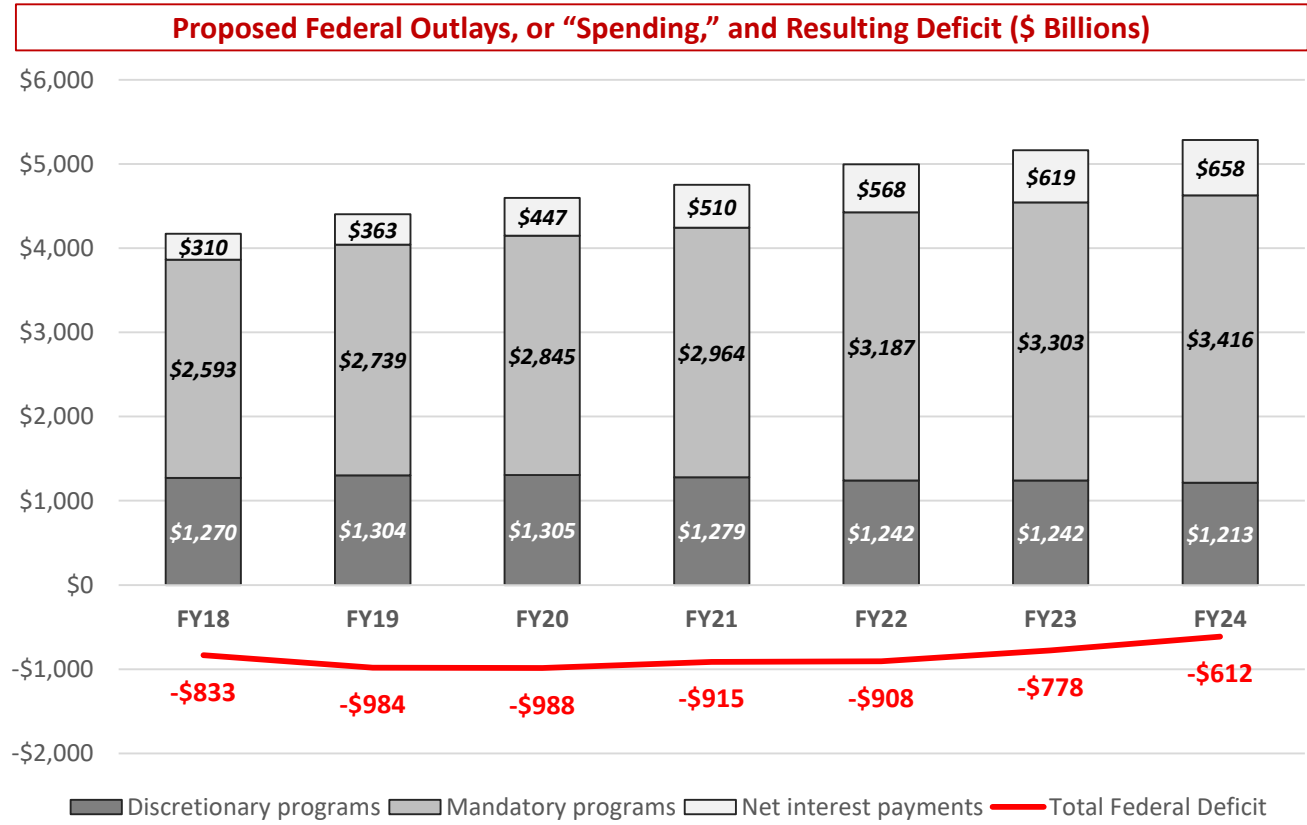
The Budget Control Act featured spending caps and automatic cuts that were thought to be so painful that it would force Congressional bipartisanship.

While those spending caps have been increased on-time in most fiscal years, they are a continued threat to DoD readiness and modernization.

Fortunately, Trump's FY19 DoD request includes legal modifications to the current spending caps.



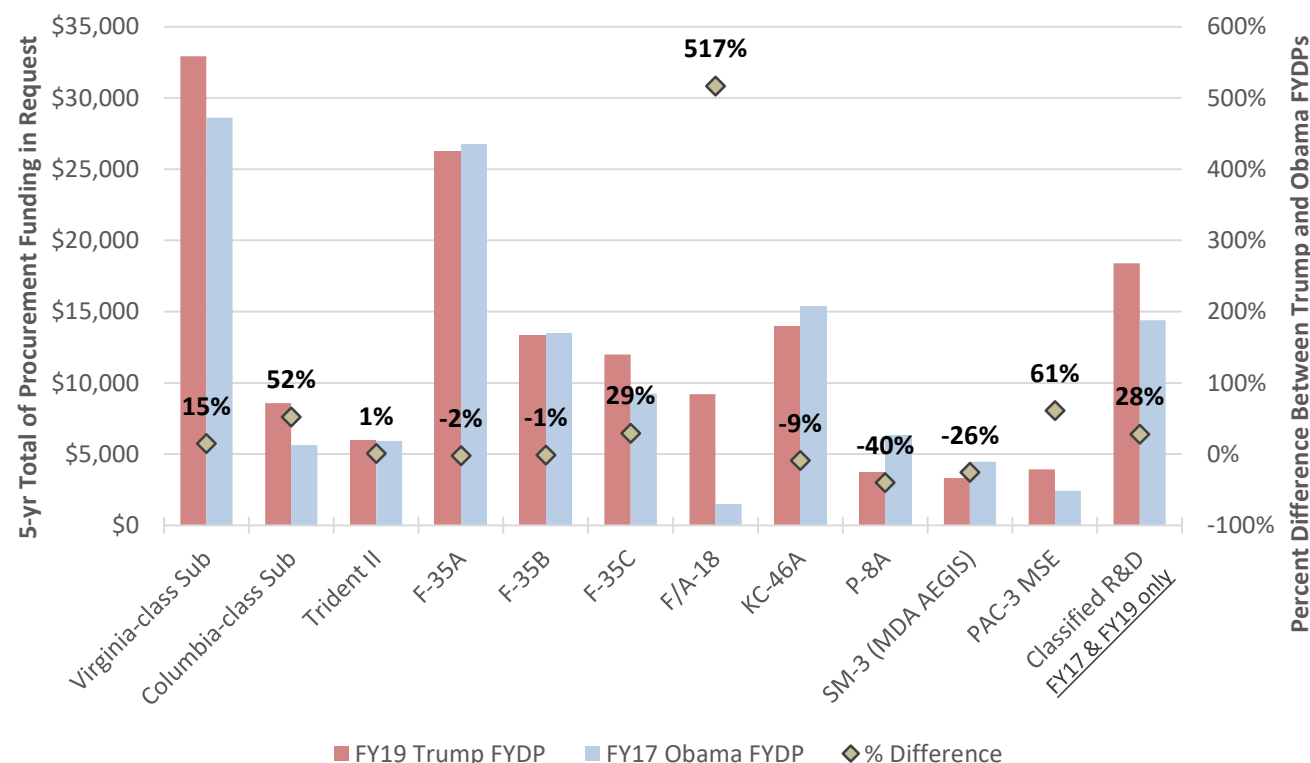
- While Congress recently passed a bipartisan increase to defense and non-defense accounts, the FY2019 PBR still faces some hurdles before becoming law
- Some Congressional Republicans, including Tea Party members and deficit hawks, feel the recent budget request would increase debt to an unacceptable level and voted against recent legislation that indicated increased future spending levels
 - According to OMB, debt under the FY2019 PBR would rise to 82% of GDP in FY2022 and the deficit will rise from \$665B to \$984B by FY2019
 - While some have voiced concern over increased spending levels, OMB data does not include a full accounting of recent – and actual – spending increases and/or tax cuts



President Trump’s Future Year Defense Plan (FYDP) suggests a positive outlook for the defense industry; however, the increased level of spending has drawn criticism from both sides of the political spectrum. Before becoming law, conservative budget hawks will have to accept that federal deficits could reach \$1 trillion as discretionary, mandatory, and interest account spending grows.

- ❑ A quick review of key programs of record indicate where funding was **increased** in investment accounts in President Trump's FY2019 request
 - Existing aircraft programs to keep manufacturing lines open longer than previously expected (F/A-18 is now funded through FY23 vs. FY18, P-8A through FY20 vs. FY19)
 - Higher procurement quantities of key missile defense interceptors (including PAC-3 MSE) and nuclear deterrent platforms (including submarines and Trident II)
 - While details are not public, the total Classified R&D request (including Army, Navy, and Air Force) in FY2019 is \$18.4B and it was just \$16.5B in FY2018 & \$14.6B in FY2017
- ❑ All platform increases drive additional requirements for supporting equipment

Comparison of The Trump FY19-23 Request And The Obama FY17-21 Request (\$M, % dif)

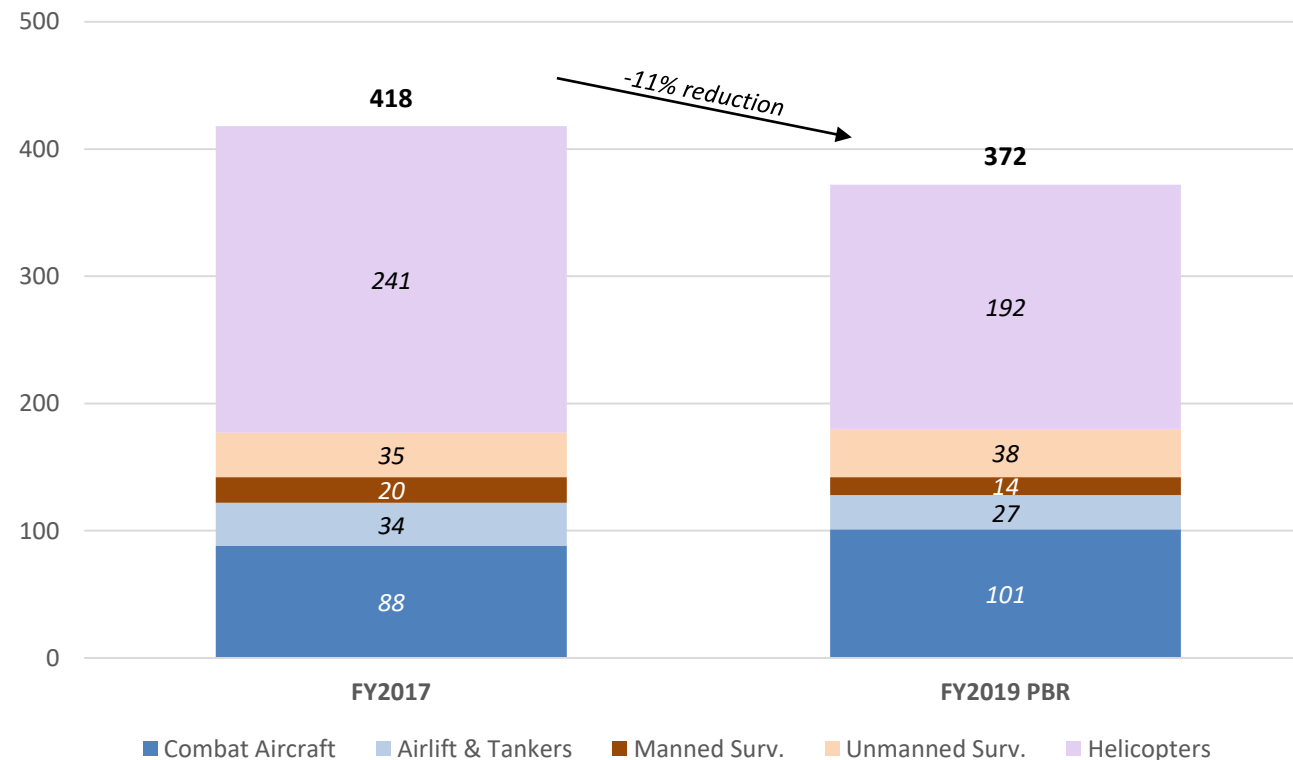


While the total DoD budget request includes hundreds of programs and even more R&D projects, a quick review of several key platforms can provide an indication of White House and Pentagon priorities.

Across just 10 programs and classified R&D accounts, President Trump's request provided +28% (+\$22.0B) more funding between FY2019-2021 than was included in President Obama's last request.

- ❑ Despite large increases to key defense programs, an awareness of budget caps and federal debt forced the White House to reduce acquisition objectives for other well-known platforms
- ❑ Across all branches of the military, total aircraft acquisition quantities in the FY2019 PBR were 46 units less than number approved in FY2017
 - Airlift & tanker quantities decrease by 21%, manned surveillance quantities decrease by 30%, and helicopter quantities decreased by 20%
 - Fewer production aircraft indicates the industrial base will face less spares, less maintenance, and less accessory requirements over the next 5-10 years

DoD Aircraft Acquisition Quantities Requested Under Obama And Trump By Platform Type



While the majority of recent news about Congress and DoD detail the positives of an increased budget, there are still risks included in the FY2019 PBR.

If President Trump is only interested in acquiring 'high profile' systems like weapons and F-35 Joint Strike Fighters, supporting platforms (e.g., C-130) and equipment (e.g., C4ISR systems) could receive less budgetary support from the White House.

- ❑ Compared to DoD budget requests under the previous Administration, President Trump's first full request creates a positive macro-market outlook for the defense industrial base
- ❑ Despite this positive outlook, the FY2019 PBR must pass a thorough review by Armed Services Committees and become law after being voted on by the entire House of Representatives and Senate
- ❑ Even if defense companies and/or investors have a positive outlook for the FY2019 budget, every player in the industrial base must consider the risks and opportunities under President Trump and Secretary Mattis
 - Will acquisition methods and existing contracts change? Will new entrants pursue the increased defense budget? Will new technologies replace legacy platforms and prime contractors? Will armed conflict change the outlook of certain programs?

Opportunities from Trump's Request and Potential Congressional Plus-ups

- Increased force structure will drive future requirements for additional soldier-level systems including optics, C2 equip, weapons, and ammunition
- DoD's published strategy indicates a renewed focus on training for a potential 'great power' competition with Russia and China; either training or conflict will require advanced technologies and programs
- High annual procurement quantities could drive per-unit prices down to a suitable level, increasing demand
- Trump's swift and high OPTEMPO activity in Iraq could be replicated again by any enemy's misbehavior

Potential Risks from Trump's Request and Other Geopolitical Events

- A2AD capabilities of near-peer adversaries could drive DoD to prioritize the procurement of older-aged, non-GPS weapons compared to next-gen technologies
- Candidate Trump repeatedly questioned the deployment of U.S. troops to places like Iraq and Afghanistan; his administration could prioritize homeland security and shift deployments accordingly
- Congress could pass a "balanced budget" amendment which would restrict the DoD's ability to utilize national debt to fund procurement programs and RDT&E projects

Fairmont maintains a proprietary federal budget database, allowing the firm to quickly answer critical questions on agencies, platforms, programs, and future opportunities amid a dynamic political climate.