European Defense Trends: Briefing Update

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CSIS

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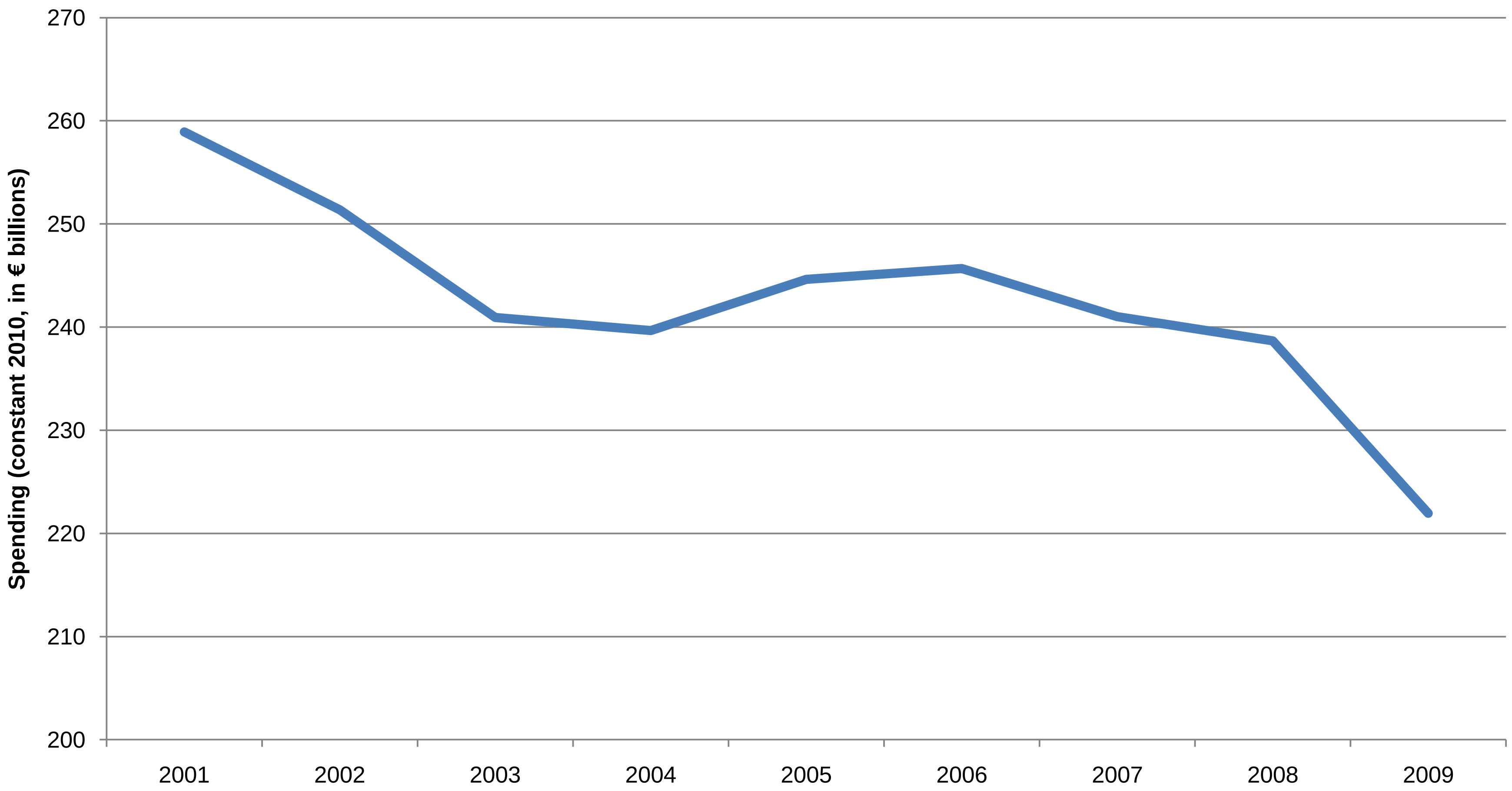
Budgetary Trends

Total European Defense Spending 2001-2009



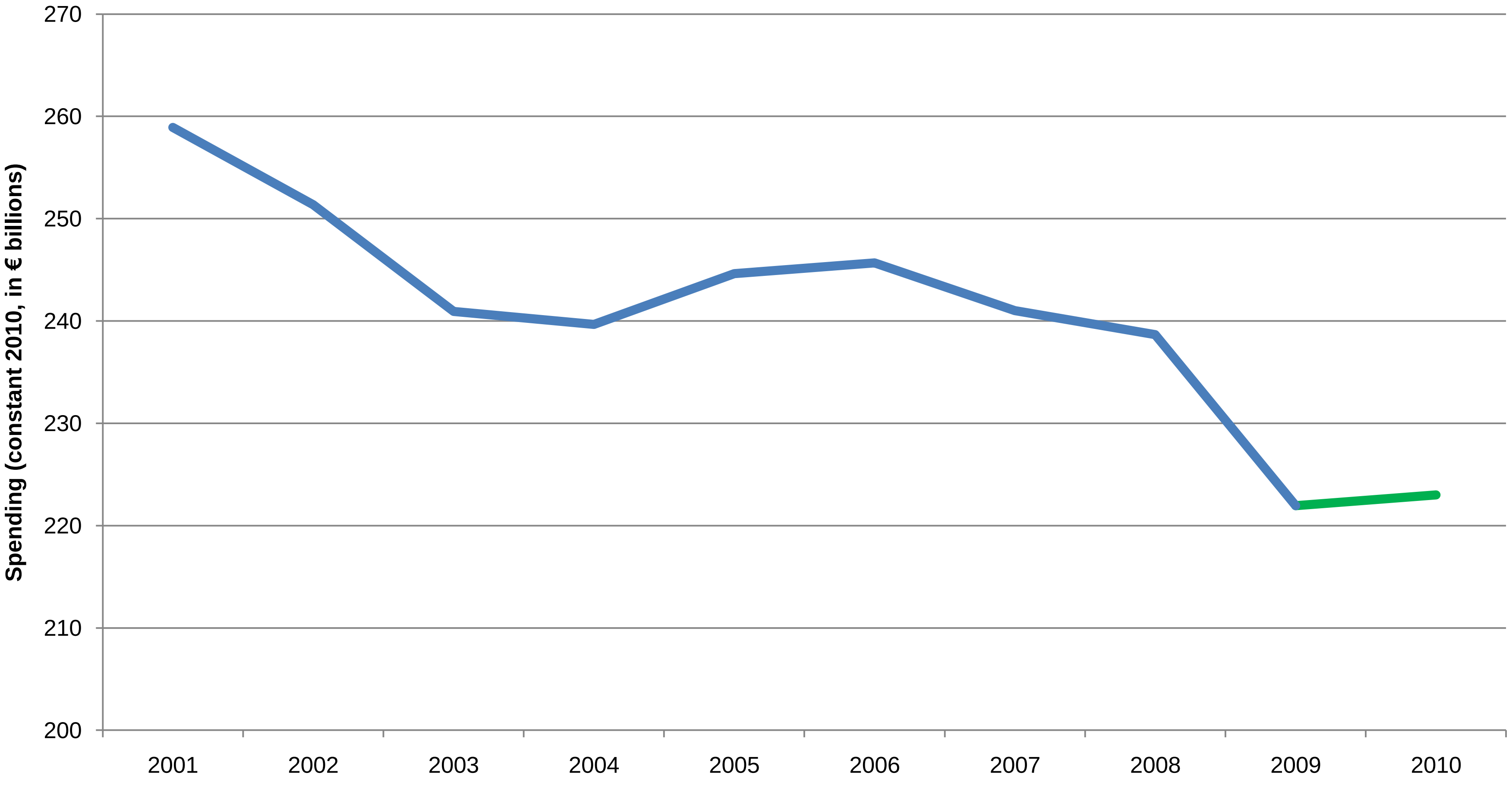
Source: CSIS (2010) *European Defense Trends: Budgets, Regulatory Frameworks, and the Industrial Base.*

2010 CSIS Projections

- **"The probability of Europe achieving any sizeable increases in defense spending in the coming years is unlikely, given European political and socioeconomic realities"**
- **"The objective of maintaining stable European defense spending might therefore prove elusive for the future"**

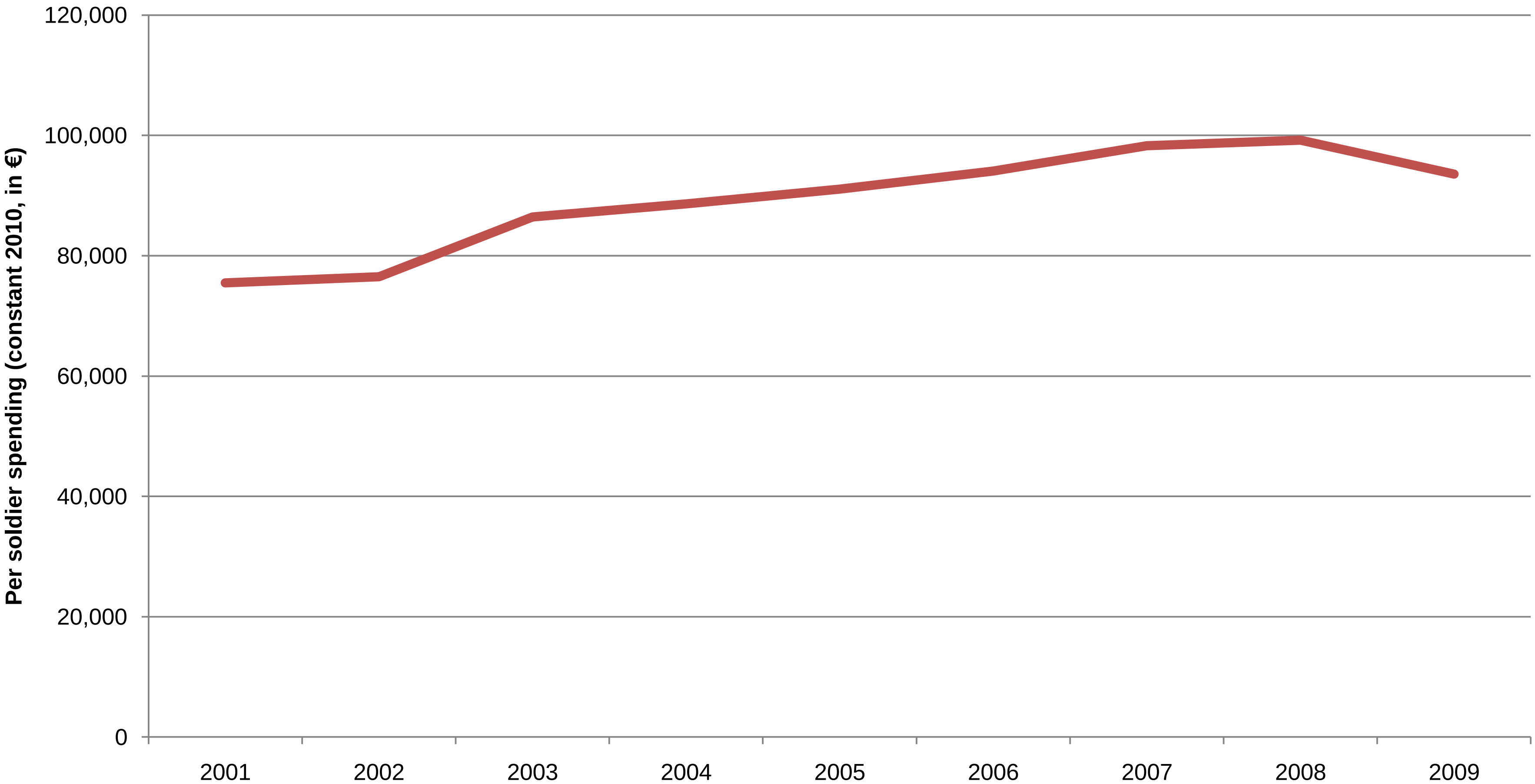
Source: CSIS (2010) *European Defense Trends: Budgets, Regulatory Frameworks, and the Industrial Base.*

Total European Defense Spending 2001-2010



Source: NATO Defense Expenditures; SIPRI Military Expenditures Database; analysis by CSIS Defense Industrial Initiatives Group.

Defense Spending Per Soldier 2001-2009



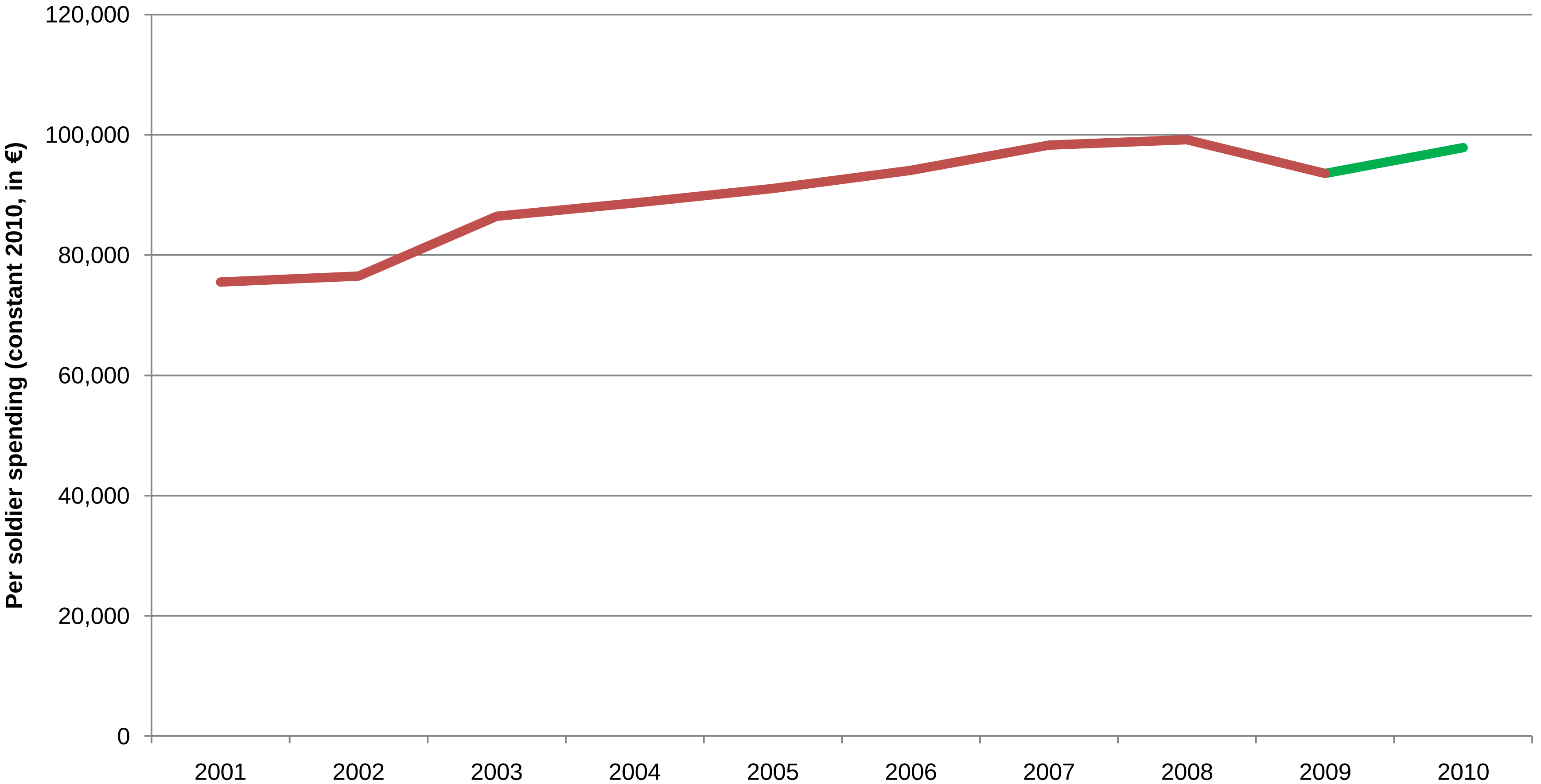
Source: CSIS (2010) *European Defense Trends: Budgets, Regulatory Frameworks, and the Industrial Base.*

2010 CSIS Projections

- **“However, it is possible that higher per-soldier spending levels would be sustainable only temporarily;”**
- **“These two data points [2008 and 2009] align with the prediction of a long-term decline in per-soldier spending, but they could also be the result of year-to-year fluctuations.”**

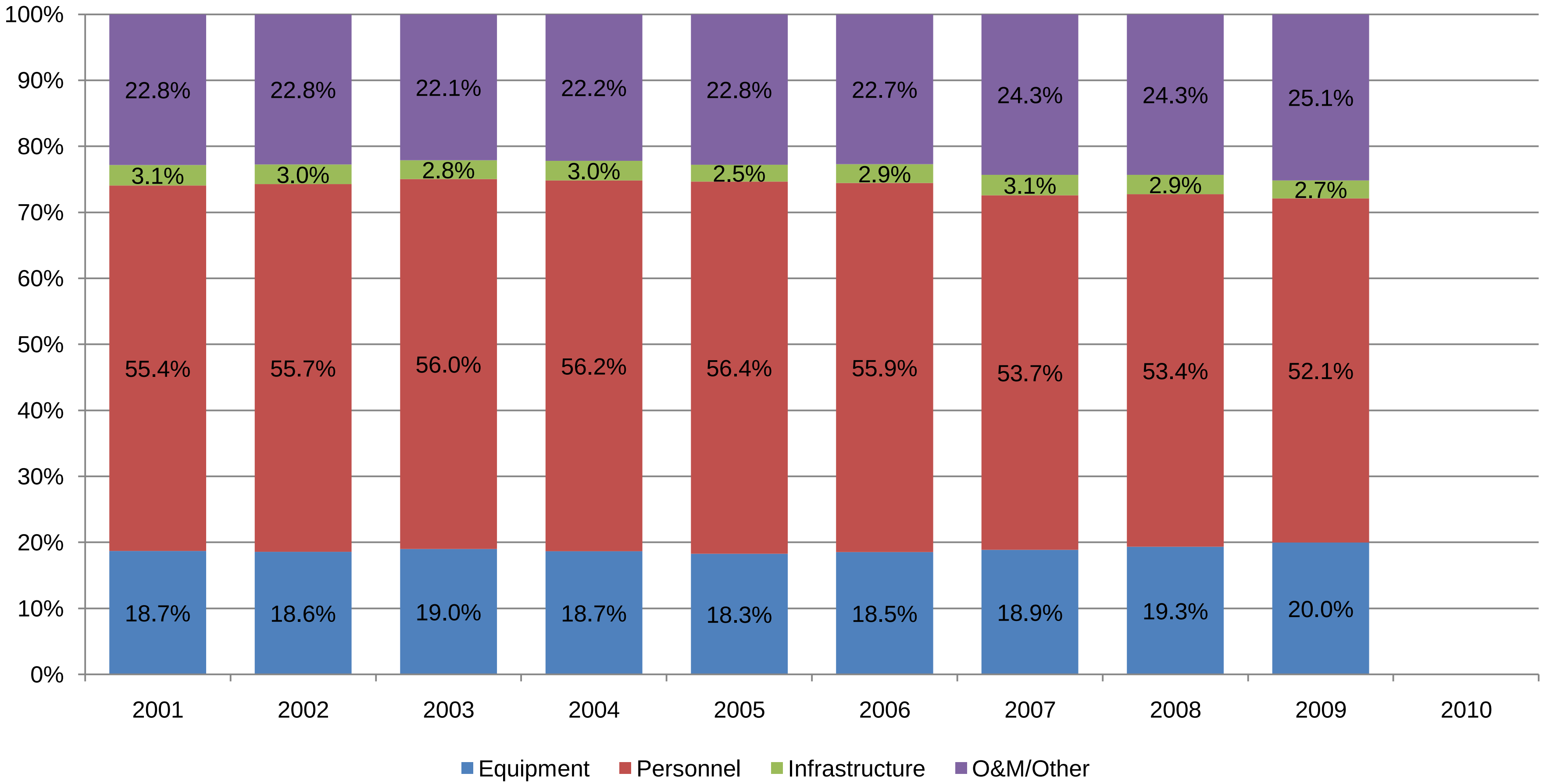
Source: CSIS (2010) *European Defense Trends: Budgets, Regulatory Frameworks, and the Industrial Base.*

Defense Spending Per Soldier 2001-2010



Source: NATO Defense Expenditures; SIPRI Military Expenditures Database; IISS Military Balance; analysis by CSIS Defense Industrial Initiatives Group.

Distribution of Total European Defense Spending by NATO Defense Spending Categories (2001-2009)



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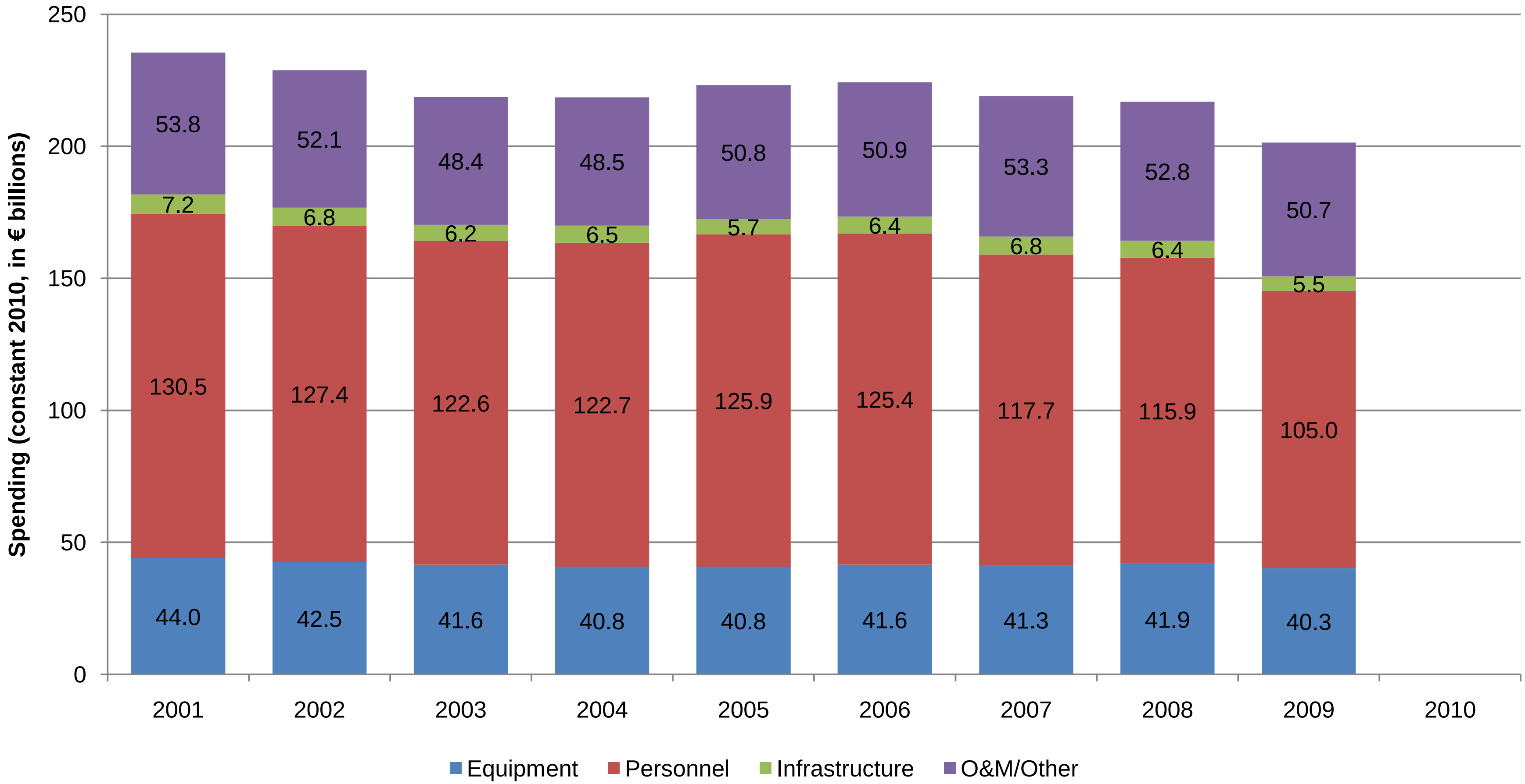

Source: CSIS (2010) *European Defense Trends: Budgets, Regulatory Frameworks, and the Industrial Base.*

2010 CSIS Projections

- **“Relative spending priorities might continue to shift toward the O&M/Other and Equipment spending categories”**
- **“Yet macro trends, such as further cuts in overall defense budgets, could force European states to reverse this trend [of shifting resources to investment accounts]”**

Source: CSIS (2010) *European Defense Trends: Budgets, Regulatory Frameworks, and the Industrial Base.*

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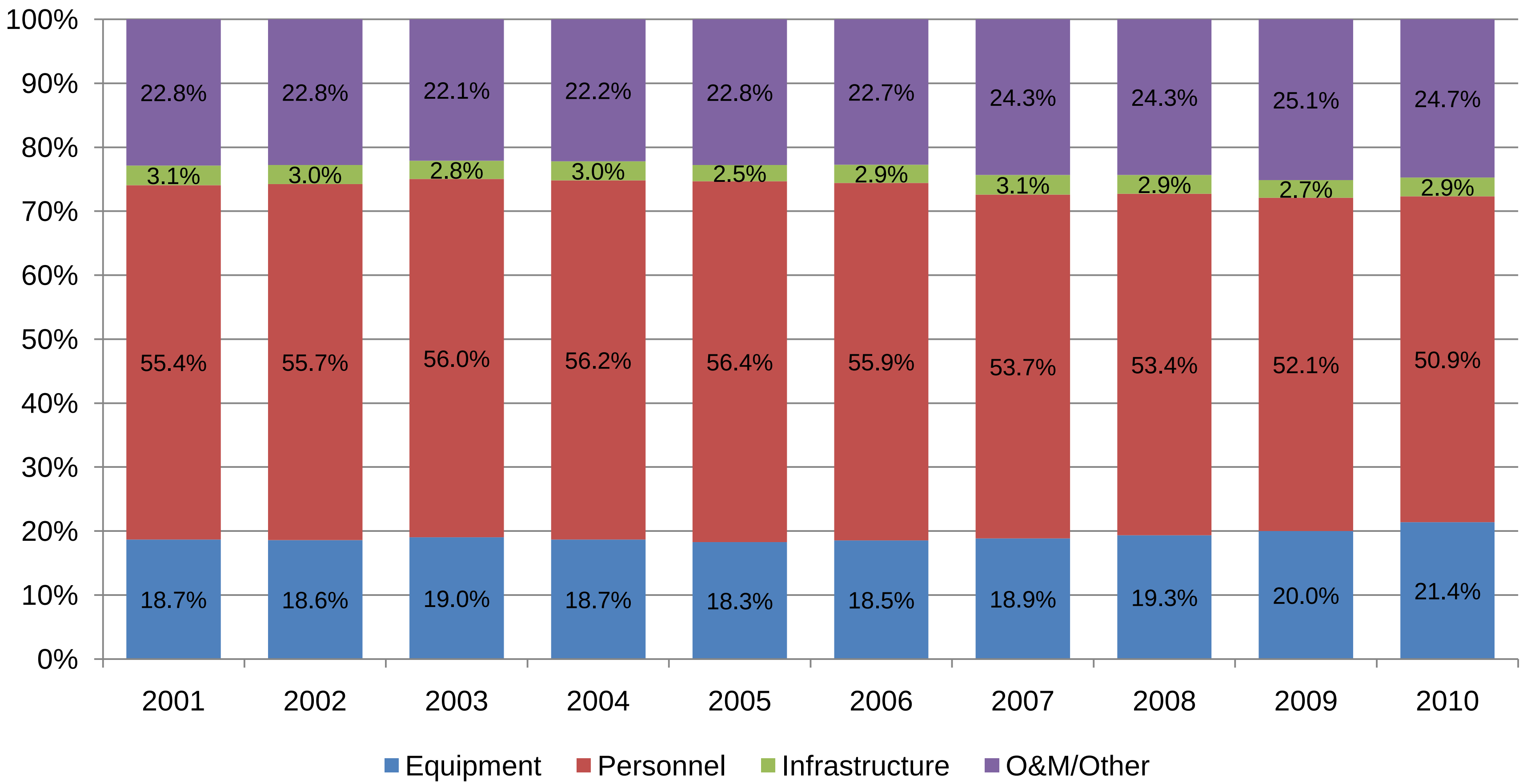

Source: NATO Defense Expenditures; analysis by CSIS Defense Industrial Initiatives Group.

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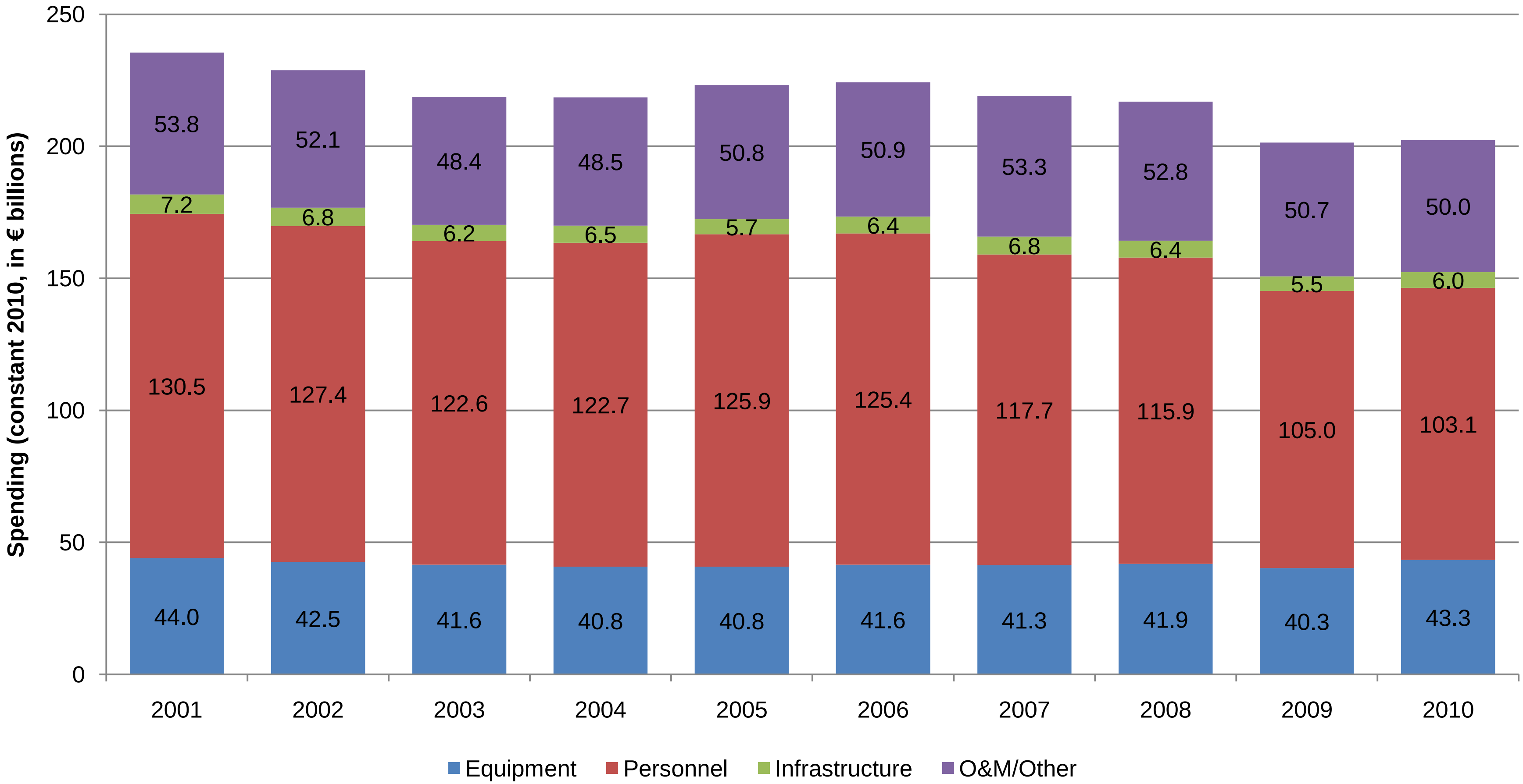


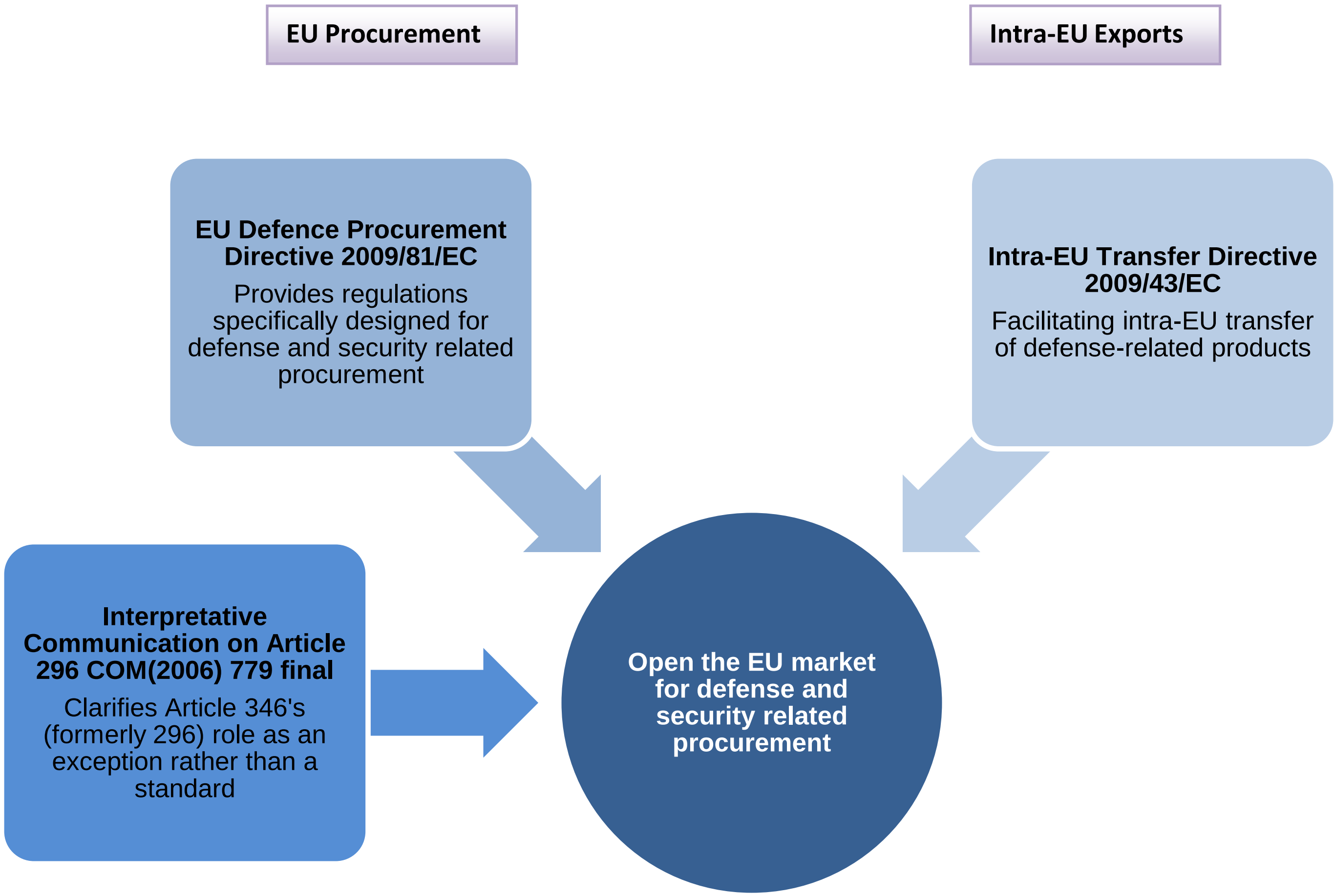
Source: NATO Defense Expenditures; analysis by CSIS Defense Industrial Initiatives Group.

Key Budgetary Developments in 2010

- **No decline of defense spending in 2010, instead a modest increase**
- **Per-soldier defense spending grew again after a slight reduction in 2009**
- **European governments continue to increase the relative share of defense spending allocated to Equipment accounts**
- **In absolute terms European governments allocated more than 3 billion euros in additional funding to Equipment spending**

Regulatory Trends

Key Regulatory Reforms for Defense Procurement



Source: CSIS (2010) *European Defense Trends: Budgets, Regulatory Frameworks, and the Industrial Base.*

2011 CSIS Projections

- **"The regulatory reform efforts initiated by the European Commission could considerably alter the European defense market."**
- **"Much will depend on the willingness and ability of the European Commission to enforce the new directives. […] Some examples in the more recent past hint at a more determined stance of the European Commission in this regard."**

Source: CSIS (2010) *European Defense Trends: Budgets, Regulatory Frameworks, and the Industrial Base.*

Implementation of EC Directives

- **To date, member states have been cautious in their implementation of the procurement directive**
- **The EC continues to push for a stricter interpretation of Article 346**
- **Member states are reportedly exerting increased pressure with regard to the EC defense procurement directive**

Key Regulatory Developments in 2011

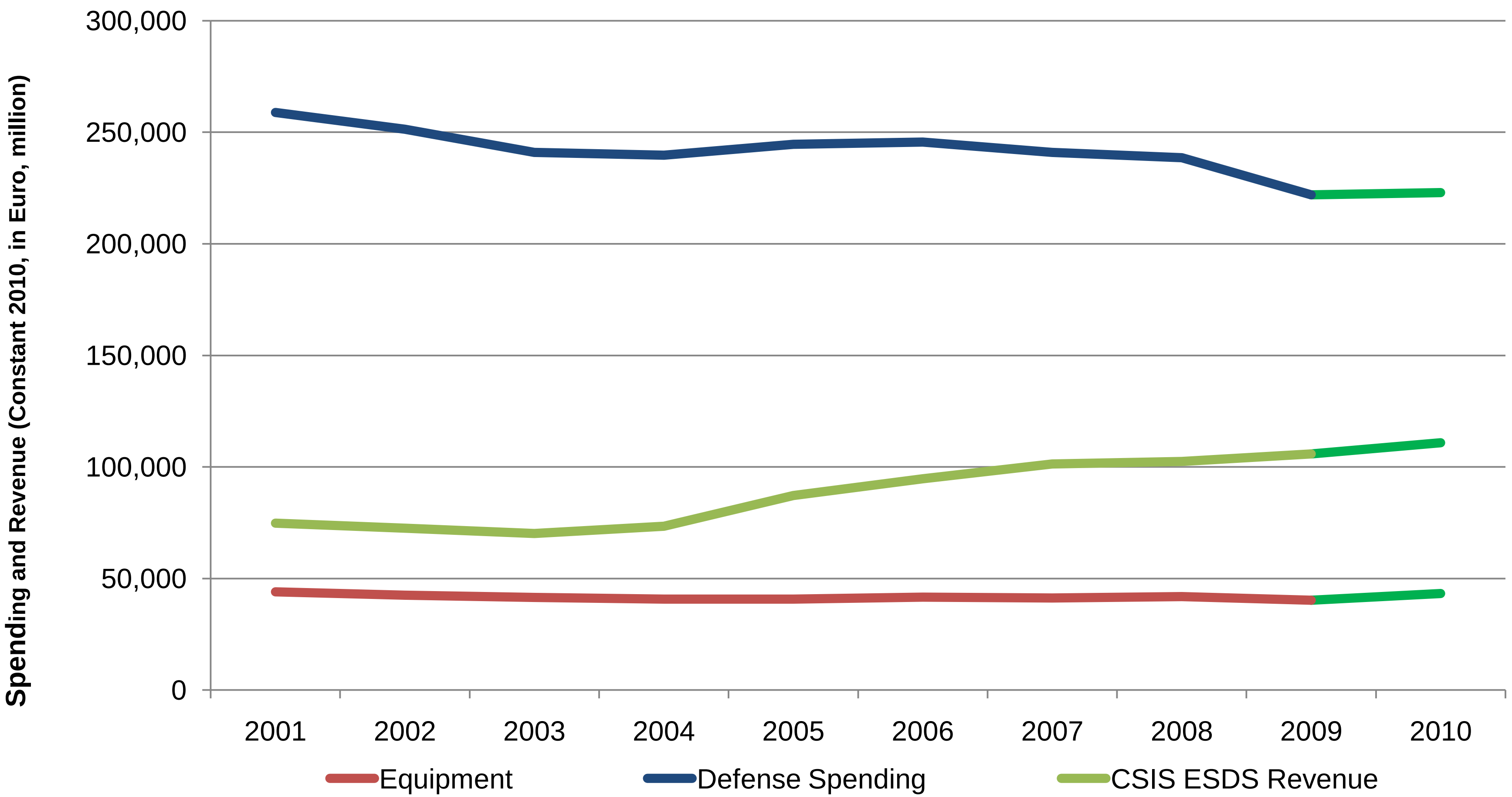
- **Impact of EU directives remains to be seen**
- **Lack of clarity regarding implementation in the foreseeable future**

Defense Industry Trends

CSIS European Security, Defense, & Space (ESDS) Index

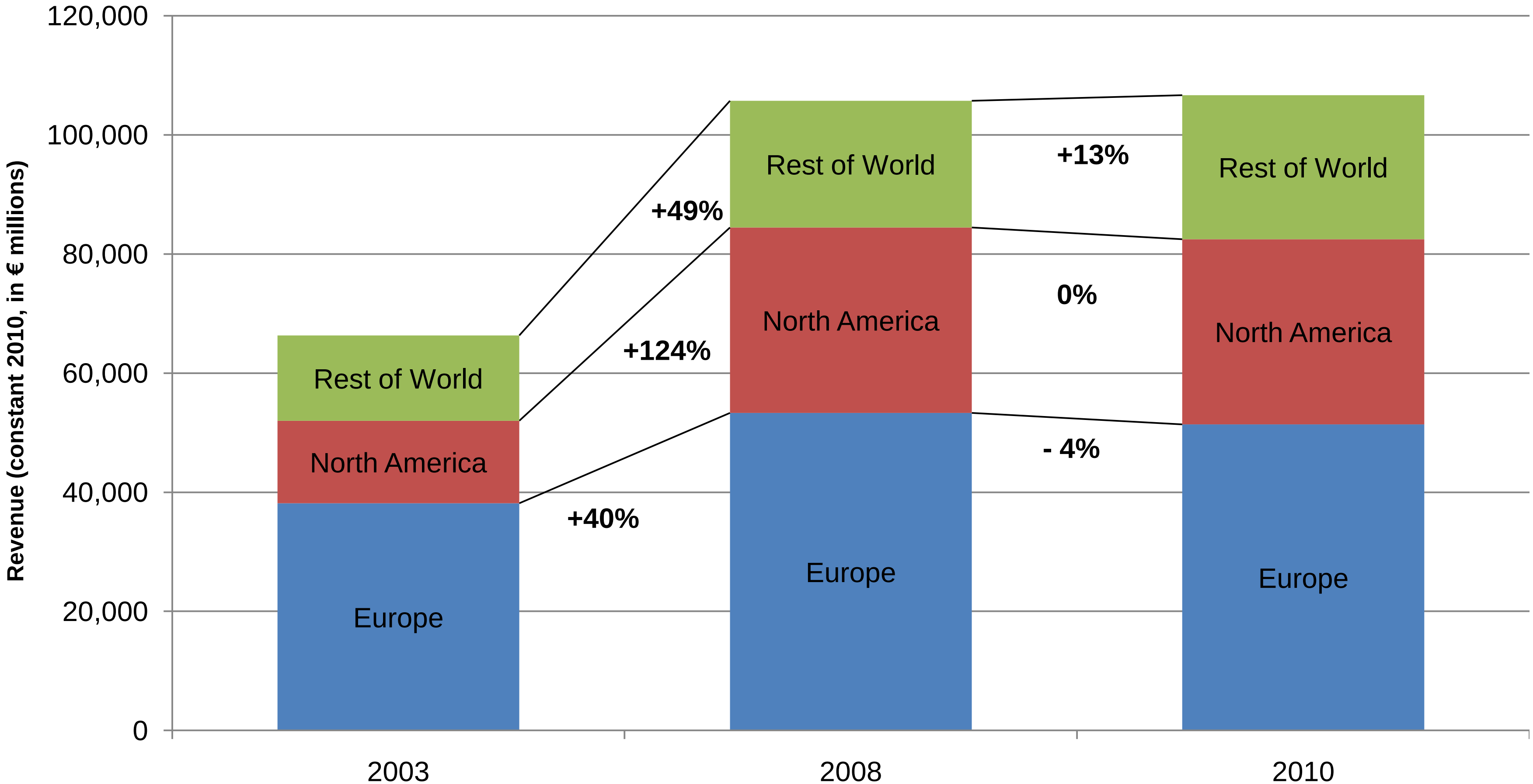
- 22 publicly traded companies from across Europe
- Annual revenue ranging from €40 million to €24 billion
- Represent both hardware and services companies, and both established and emerging capabilities
- Many operate non-defense businesses
- Benchmarked to the industrial component of the MSCI Europe Index

CSIS ESDS Index: Revenue and European NATO Defense Spending (2001-2010)



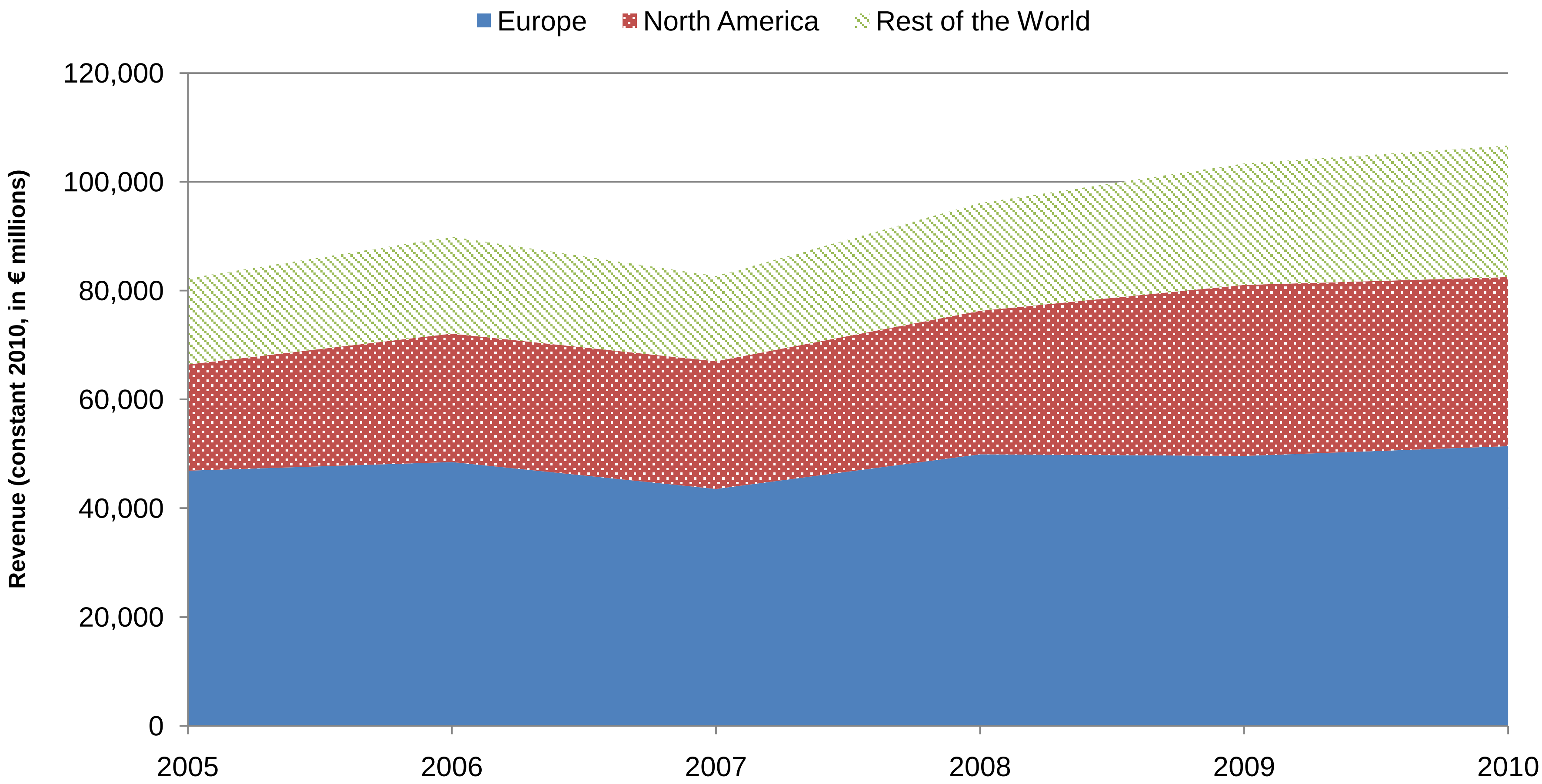
Source: NATO Defense Expenditures; Bloomberg; company financial reports; analysis by CSIS Defense-Industrial Initiatives Group.

CSIS ESDS Index: Revenue by Geographic Origin (2003, 2008, and 2010)



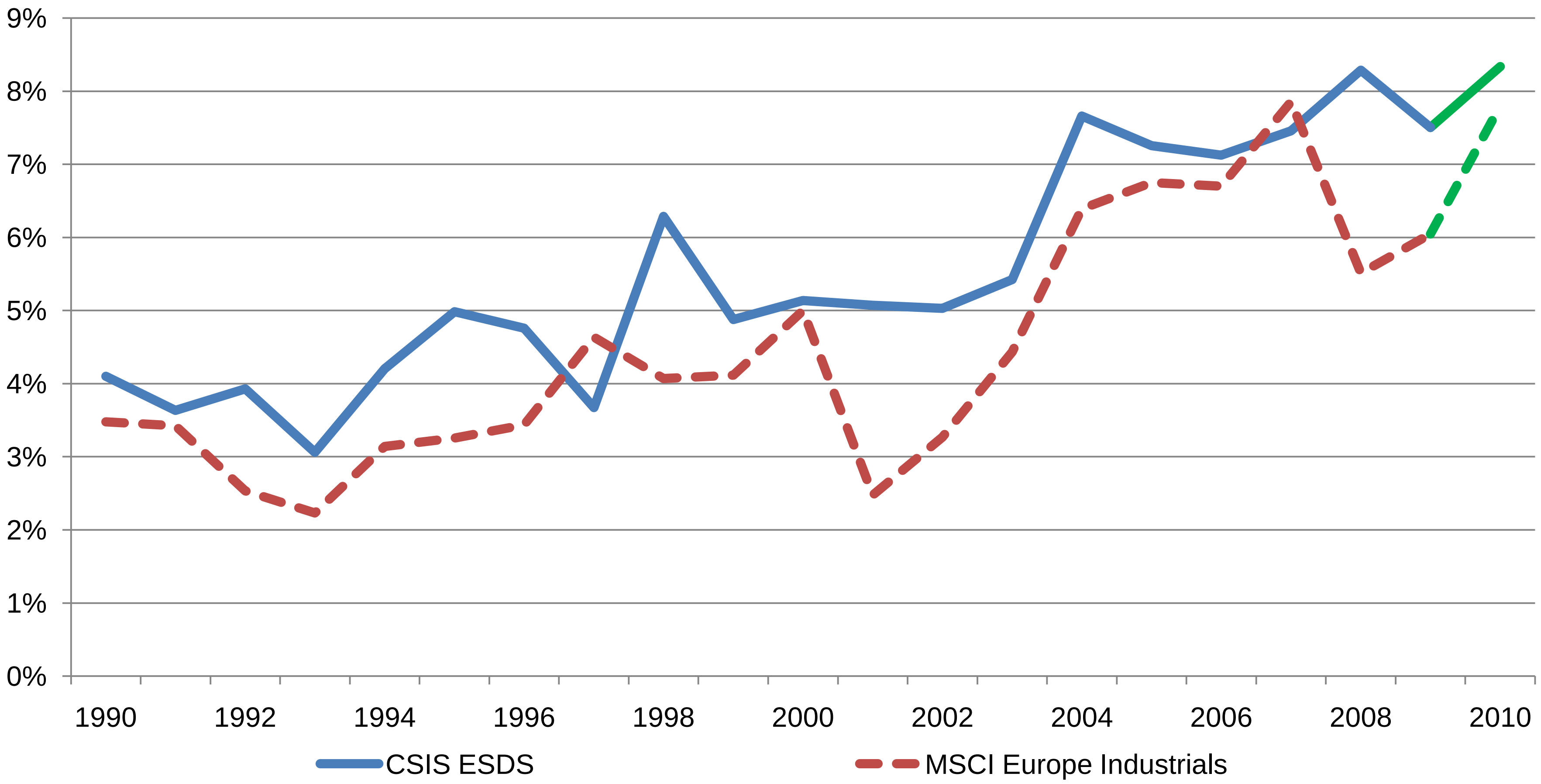
Source: Bloomberg; company financial reports; analysis by CSIS Defense-Industrial Initiatives Group.

CSIS ESDS Index: Revenue by Geographic Origin (2005- 2010)



Source: Bloomberg; company financial reports; analysis by CSIS Defense-Industrial Initiatives Group.

CSIS ESDS and MSCI Europe Industrials: Operating Margin Comparison, Revenue-Weighted (1990-2010)



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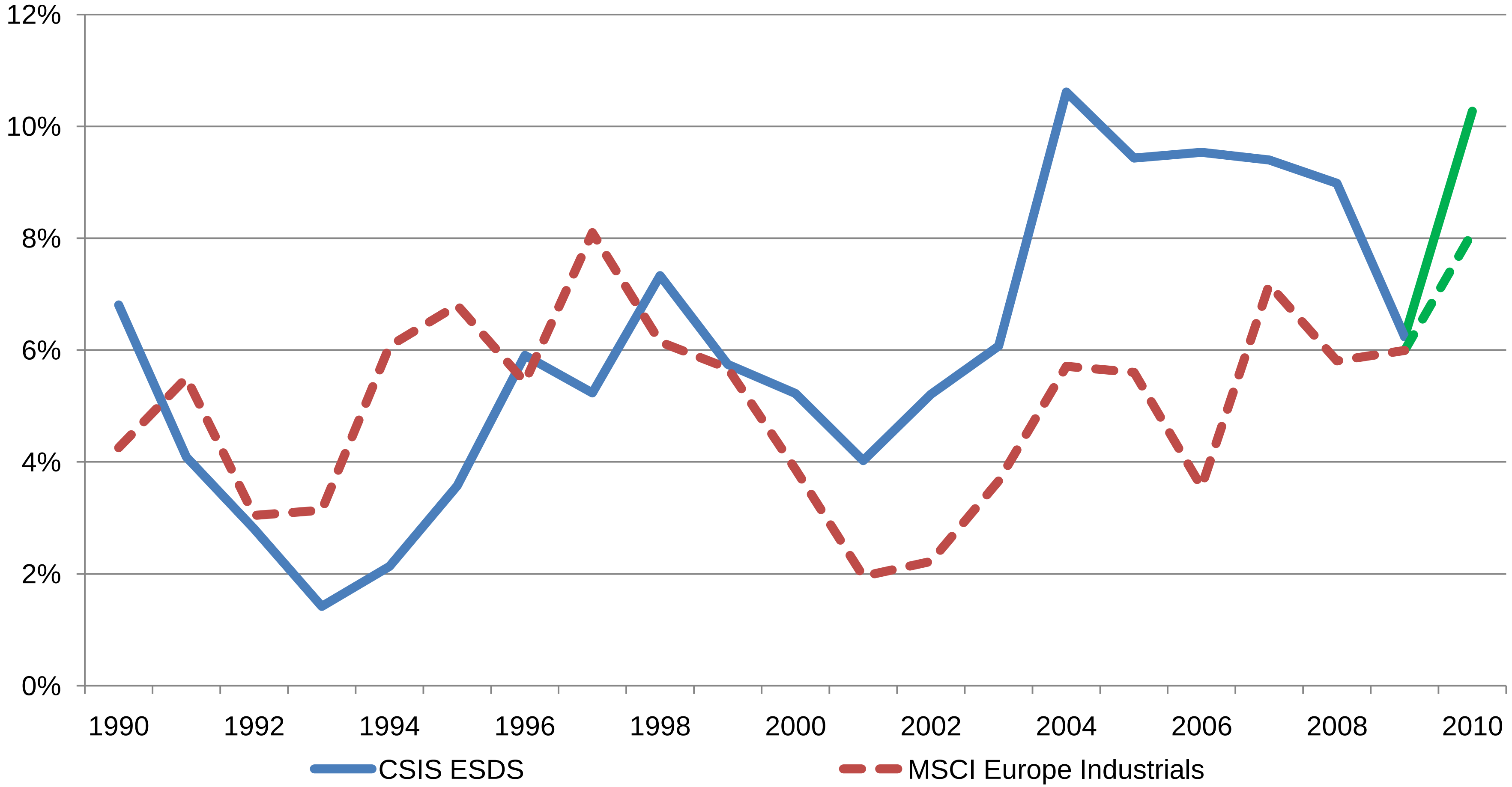
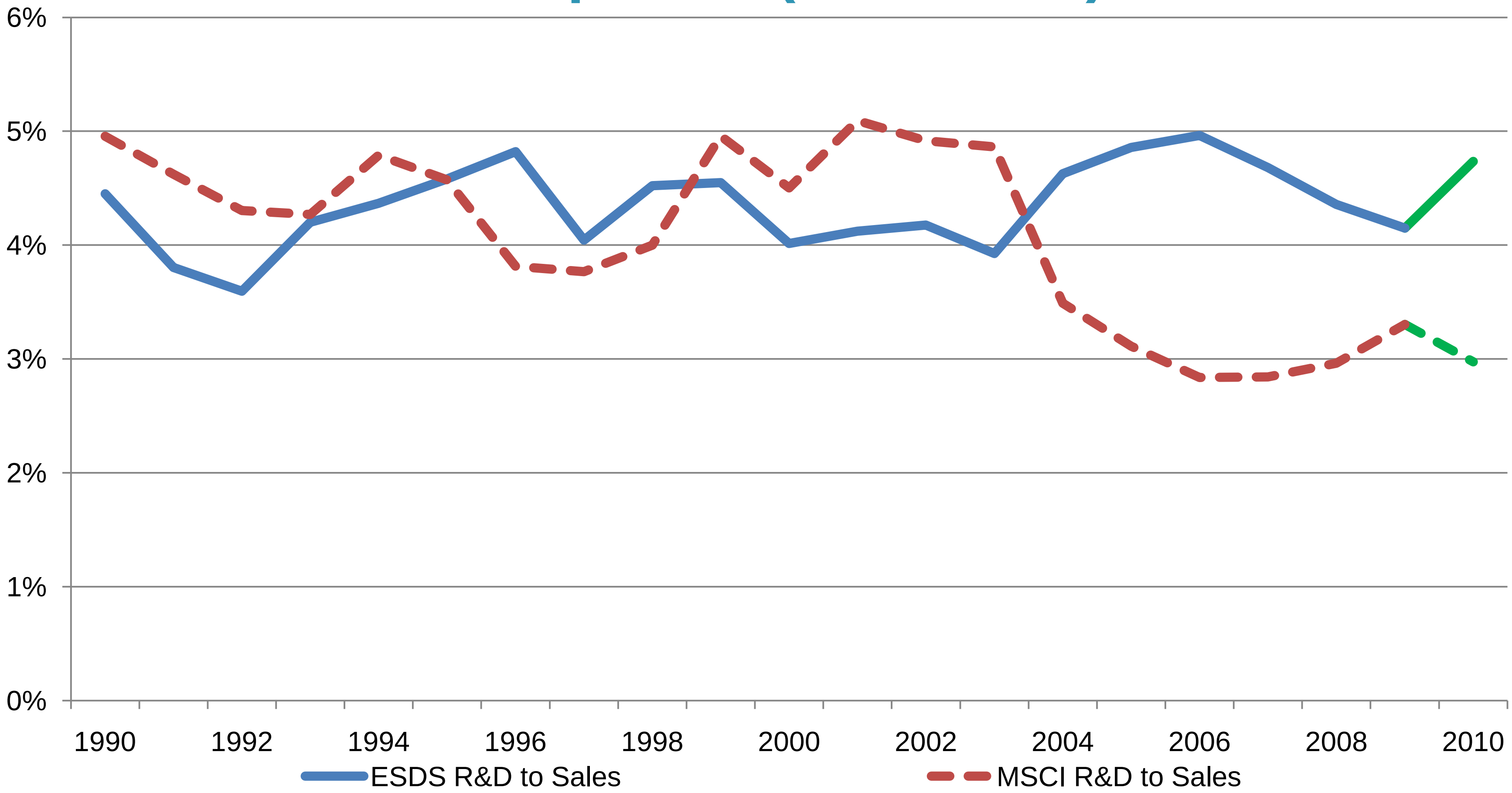
CSIS ESDS and MSCI Europe Industrials: Return on Invested Capital Comparison (1990-2010)



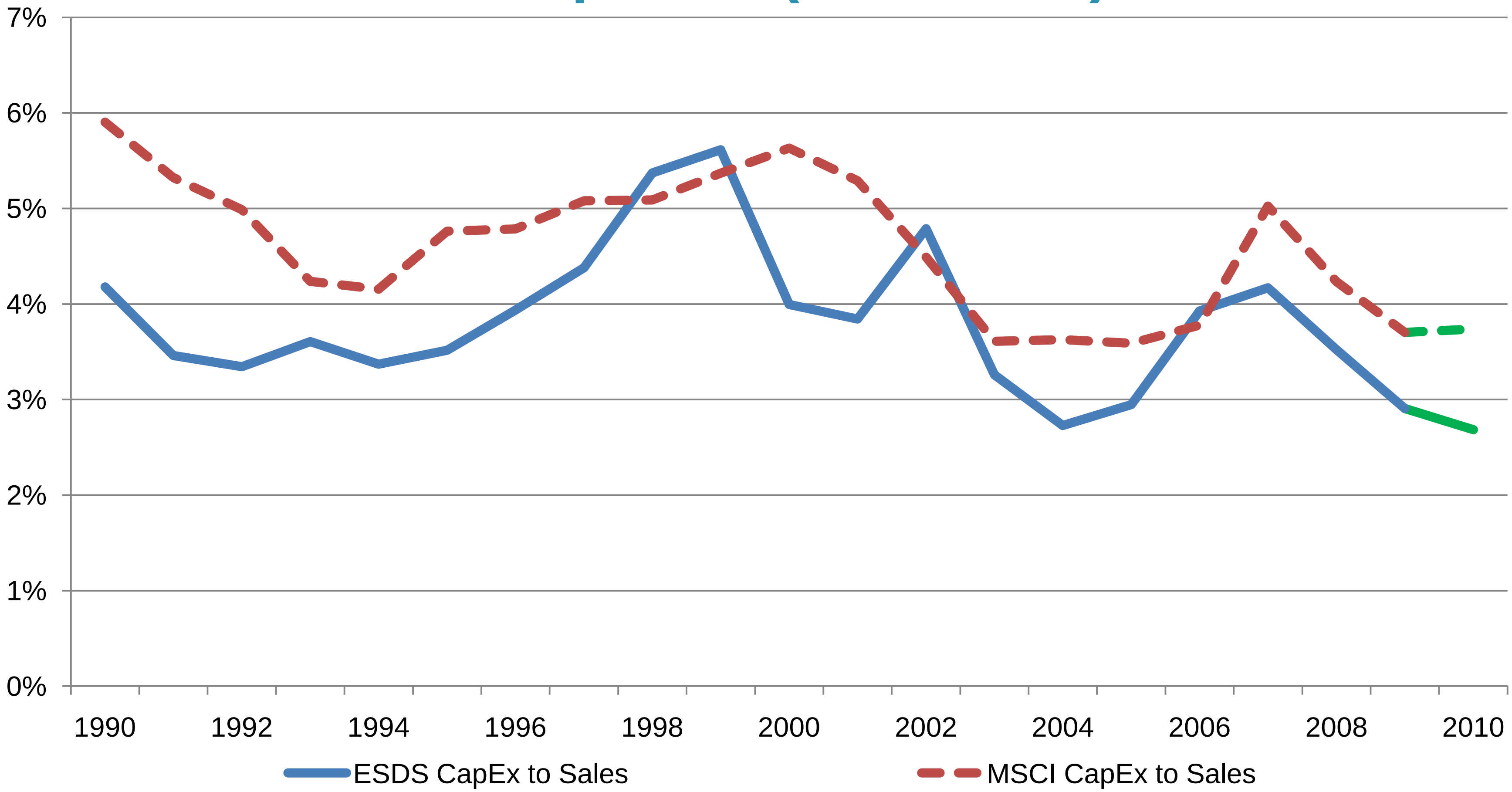
Source: Bloomberg; company financial reports; analysis by CSIS Defense-Industrial Initiatives Group.

CSIS ESDS and MSCI Europe Industrials: R&D as Percentage of Revenue Comparison, Average of Index Companies (1990-2010)



Source: Bloomberg; company financial reports; analysis by CSIS Defense-Industrial Initiatives Group.

CSIS ESDS and MSCI Europe Industrials: CAPEX as Share of Revenue Comparison, Average of Index Companies (1990-2010)



Source: Bloomberg; company financial reports; analysis by CSIS Defense-Industrial Initiatives Group.

Key Defense Industry Developments in 2010

- CSIS ESDS companies' revenue, margin, and ROIC continue to expand
- No growth in revenue from the European and North American defense and security markets
- Index average R&D as share of revenue increased while CapEx as share of revenue declined

Conclusions and Recommendations

European governments should:

- Reduce unnecessary redundancies
- Avoid unwarranted capability gaps
- Continue to protect investment accounts
- Explore meaningful opportunities for multinational collaboration and pooling
- Broaden dialogue with industry
- Ensure that increased Equipment funding is spent on operationally-relevant output

Conclusions and Recommendations

European Union should:

- Continue to push for the implementation of the directives
- Ensure adherence to a stricter interpretation of Article 346

Conclusions and Recommendations

Defense industry :

- CSIS ESDS Index companies are globally competitive
- Index companies are taking a short–term view of the market
- European defense and security firms should continue diversification toward non-European/U.S. markets

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