

The Krause Fund

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Lockheed Martin Corp. (LMT)

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Industrials – Aerospace & Defense

Stock Rating

Buy

Investment Thesis

We recommend a **Buy** rating for Lockheed Martin with a target price of \$638.81, showing an upside of 26% from the current share price of \$513.40. Driven by a strong backlog of guaranteed revenues combined with increasing government defense budgets, Lockheed Martin looks to maintain its position as a top firm within its industry.

Drivers of Thesis

Record strong backlog:

Lockheed Martin's \$193.6B backlog in 2025 provides multiyear revenue visibility. MFC backlog up 20% YoY supports our 9.3% MFC growth forecast.

U.S and Allied Defense Budget tailwinds:

U.S Defense budget is on a path to 1.5T by 2027, up from 901B. Combined with allied rearmament and NATO's 5% of GDP commitment, this drives growth across all four segments.

Structural Capital Efficiency:

Invested capital turnover climbs from 3.01x (2025) to 3.69x (2035) as goodwill shrinks against a growing revenue base, driving 30.9% terminal ROIC.

Risks to Thesis

Program write downs

4B in pretax reach forward losses over three consecutive years. Continued charges under fixed price contract terms would compress margins and reduce our DCF target.

Political and Budget Volatility

Our growth assumptions rely on 1.5T U. S defense budget. Shutdowns or administration changes in 2028 could slow defense spending industry wide.

Target Price

\$000-000

Krause Fund DCF \$638.81
Relative Multiple \$759.79

Price Data

Current Price \$513.40
52wk Range \$410.11 – 692.00
Consensus 1yr Target \$673.10

Key Statistics

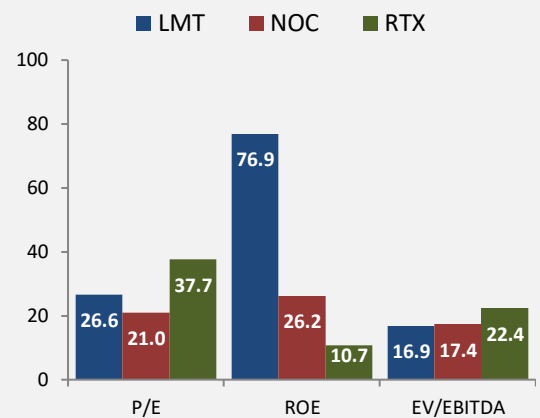
Market Cap (B) \$131.81
Shares Outstanding (M) 229
Institutional Ownership 74.80%
Beta 0.46
Dividend Yield 2.48%
Est. 5yr Growth 15.1%
Price/Earnings (TTM) 22.51
Price/Earnings (FY1) 18.52
Price/Sales (TTM) 1.50
Price/Book (mrq) 16.48

Profitability

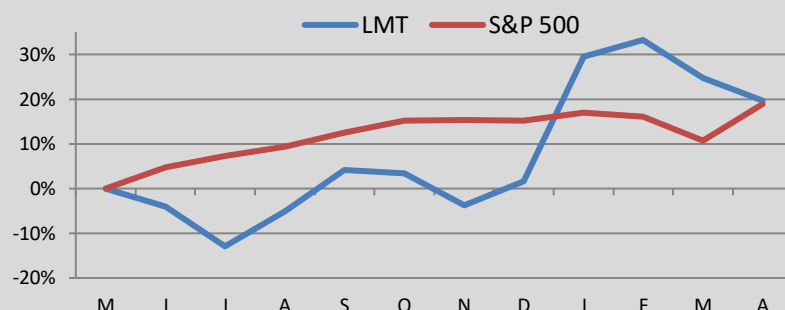
Operating Margin 9.90%
Profit Margin 6.69%
Return on Assets (TTM) 8.69%
Return on Equity (TTM) 76.87%

Earnings Estimates

| Year | 2023 | 2024 | 2025 | 2026E | 2027E | 2028E |
|---------|---------|---------|---------|---------|---------|---------|
| EPS | \$27.55 | \$22.31 | \$21.49 | \$29.99 | \$32 | \$33.96 |
| KF est. | | | | \$29.41 | \$31.24 | \$33.97 |
| growth | 27.19% | -19.02% | -3.68% | 36.37% | 6.21% | 8.73% |



12 Month Performance



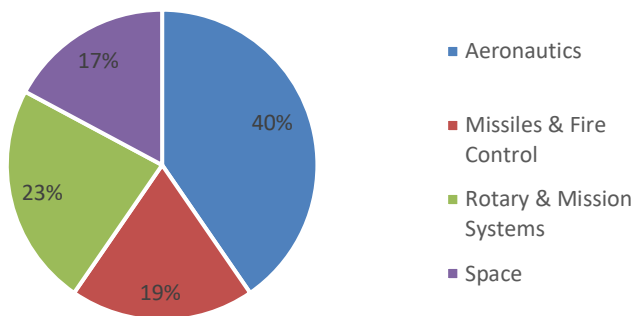
Source "FactSet"

Source "Yahoo Finance"

COMPANY DESCRIPTION

Lockheed Martin is the world's largest defense company that develops advanced technology systems for the U.S. government and allied nations. The company generates revenue through long-term contracts across their four segments: Aeronautics (F-35), Missiles and Fire Control, Rotary and Mission systems, and Space systems. Its business model is characterized by high barriers to entry, long product lifecycles, and significant reliance on government defense spending.

Net Sales 2025



Aeronautics

The Aeronautics segment is the largest business line for Lockheed Martin, generating approximately **40% of total company revenue in 2025**. The segment primarily produces advanced military aircraft, including the F-35, F-22, and F-16. **The F-35 program alone generated 27% of the total consolidated net sales in 2025** serving as a dominant revenue driver. We forecast Aeronautics revenue to grow by **6%** annually over the next 10 years, driven by sustained production and modernization of the F-35 program. Lockheed Martin delivered a record number of 191 F-35s in 2025. Annual production is now running at a pace five times faster than any other allied fighter in production. Additionally, our 6% growth assumption is driven by the fact that the F-35 continues to prove its performance in real world combat operations including: playing a key role in suppressing Iran's air defenses in operation Midnight Hammer, along with eliminating Russian drones over Poland. 12 nations are now operating the F-35 across the global fleet, and with there being 1,300 aircraft in service we expect reoccurring revenue streams through sustainment, maintenance, and upgrades.

Rotary & Mission Systems

The Rotary and Mission Systems segment is a diversified business unit within Lockheed Martin contributing to

approximately 23% of total sales in 2025. This segment includes military helicopters such as the Black Hawk, as well as naval combat systems, and Radar technologies. We forecast RMS revenue to grow to 2.34% annually over the next 10 years, reflecting a mature low-growth business segment. Sales in 2025 increased primarily due to higher production volume on Black Hawk programs, however operating profit decreased due to unfavorable profit adjustments on Black Hawk programs. These adjustments highlight the execution risk inherent in fixed price defense contracts. We incorporate these dynamics into our forecast by maintaining a conservative growth outlook, recognizing that while RMS benefits from a large installed base it's also exposed to margin volatility. Backlog at the segment level and as whole continues to increase. RMS backlog saw growth from 38,117 in 2024 to 47,715 in 2025 showing strong revenue visibility allowing us to continue to forecast growth in the segment.

Missiles & Fire Control

The Missiles and Fire Control segment is the fastest growing segment within Lockheed Martin, generating approximately **19.25% of company revenue posting a 13.94% year-over-year growth in 2025**. This segment produces critical defense systems, including PAC-3 MSE interceptors, THAAD, HIMARS, and JASSM/LRASM missile programs. This segment operated with the **highest operating margin within Lockheed Martin at 13.76%**, however we expect this margin to drop due to a significant increase in production to meet the demand. We forecast Missile & Fire Control revenue to grow by 9.31% over 5 years before dropping back down after reaching a more stable maturity because of recent demands for the PAC-3 MSE and THAAD following geopolitical conflicts depleting the supply of interceptors.

Space

The Space segment accounts for about **17.36% of sales, generating about \$13.03B in 2025**. The segment is involved in producing satellites, space transportation systems, defensive strike systems, and critical intelligence gathering. The key drivers for the Space segment include Trident II D5 Ballistic Missiles, Orion spacecraft, GPS III, and NGI. We project a stable 3.19% growth rate based upon their large programs in the Trident II D5 and GPS III being well established and matured projects providing stable revenue growth. Alongside the success of Artemis II launch the Orion program provides an annual cadence for each planned launch. These projects lay the foundation for a stable positive revenue stream from the Space segment.

ROIC & Value Creation Analysis

Lockheed Martin is a **high turnover, moderate margin** business. Margins are structurally capped by government contracts (9-14% NOPBT historically), while invested capital has risen steadily from **1.64X (2016) to 3.34x (2025)**. Turnover is the primary driver of ROIC.

Historically, ROIC averaged approximately 25%. Ranging from 12.5% (2016, post Sikorsky acquisition inflated IC) to 33.4% (2021, peak F-35 volume). The post 2021 compression of ROIC is due to fixed price contract charges on F-35 and classified space programs. The 2025 recovery to 27.3% is driven by Missiles and Fire control revenue growth of about 13.9% YoY.

We forecast ROIC to grow from 24.5% in 2026E to 30.9% in 3035E. Change in ROIC is driven primarily by improving capital efficiency rather than margin expansion. NPOBT margin is held roughly flat at 10%-10.2%.

ROIC exceeds WACC (6.72%) in every historical and forecasted year making growth value creative.

Cost Structure Analysis

Lockheed Martin is a prime defense contractor whose cost base is dominated by a single line item: **Cost of Sales**, which averaged 88.6% of revenue over the last decade and represented 89.9% of revenue in 2025. The remaining costs consist of severance charges, and other unallocated net line which captures FAS/CAS pension adjustments, stock-based compensation, and net profit booking rate adjustments. Since COGS is so dominant operating margin and gross margin tracks within 30 bps of each other historically.

Between 2015 and 2021, Lockheed expanded gross margin from 11.1% to a peak of **14% in 2019**, with operating margin following a similar path (11.6% - 14.3%). This was driven by F-35 production ramp generating fixed cost absorption as Aeronautics scaled. Margins then compressed meaningfully; gross margin fell to 9.8% in 2024. Lockheed recorded losses of approximately 2 billion tied to classified programs. Gross margin recovered only modestly in 2025 to 10.2% due to unfavorable profit booking rate adjustments. Cost overruns are absorbed entirely by the contractor rather than passed through.

The majority of COGS is variable (direct materials, labor), and the rest is a fixed cost base that drives leverage. In

2024 we saw negative leverage as revenue grew 5.1% operating profit fell by more than 17% because of fixed price charges.

We project operating margin to expand to 44 bps, from 10.3% in 2025 to 10.7% in 2035 and gross margin to expand 46 bps over the period. This is conservative because we view fixed price exposure as a structural risk rather than a one-time occurrence.

Invested Capital Analysis

Lockheed Martin is best described as moderately fixed capital intensive with meaningful intangible capital remaining from M&A. Total invested capital has a percentage of next year's revenue has fallen from 60.8% in 2016 to 33.2% in 2025, with invested capital turnover nearly doubling from **1.64x to 3.01x**. This improvement is driven by intangible capital burning off as goodwill stays static while revenue grows, and the working capital base not growing rapidly due to contract liabilities growing alongside contract assets.

Working capital

The two largest components of working capital are contracts assets and contract liabilities. In 2025 contract liabilities jumped to 11.4B up from 9.8B in 2024 while contract assets remained roughly flat at 13B. This reflects a one-time step up from the seven-year PAC-3 framework agreement prepayment structure. We assume contracts assets to revert to 17% of revenue and contract liabilities to 13%, a long run average consistent with historical behavior. Customer prepayments act as a meaningful offset to contract assets.

Fixed Capital

PP&E has held in a tight 12-13% range for a decade, demonstrating that revenue per dollar of Net PP&E is relatively stable, not improving much. Capex is rising sharply in the near term as management guided a step up to support F-35 lots, and Pac 3 MSE capacity expansion from 620 units annually in 2025 to 2,000 units annually by 2030. We model fixed capital at a steady 12.7% of revenue implying the 2026 step up implied by management will be absorbed over a few years as new capacity turns into revenue.

Intangible Capital

Goodwill (11.3B) and net intangibles (1.9B) are held flat in our forecast. As revenue compounds, intangible capital falls from 17.4% of next year's revenue in 2025 to 10.4% by 2035, a 700-bps drop. This is the single largest driver of our forecasted IC turnover improvement from 3.01x to 3.69x.

Lockheed Martin is becoming a more scalable business not because it needs less fixed capital but because **customer prepayments partially offset the working capital build and legacy goodwill becomes a shrinking portion of a growing revenue base.**

MARKETS AND COMPETITION

The U.S defense prime industry is a highly concentrated and rationally competitive structured around five companies: Lockheed Martin, RTX, Boeing, Northrop Grumman, General Dynamics. Barriers to entry are extreme like security clearances, specialized workforces, decade long production lines. This has preserved the five-prime structure for over 30 years.

Competition is not prime based but rather driven by technology and scale. Once a prime wins a platform competition like the F-35 for example, you're looking at 30–50-year production and sustainment making the switching costs for the Department of War insanely high. This is why the industry sustains operating margins of approximately 10-13% across the primes and why individual wins on multi-decade programs dictate long term returns. The industry is in a growth phase of the cycle, driven geopolitical tensions, and a U.S defense budget path toward 1.5 trillion by 2027 per the Trump administration.

The Department of War is Lockheed Martin's single largest customer and holds substantial power via fixed price contracts. Internationally, Foreign Military Sales carry higher margins but are subject to State Department and Congressional approval.

Lockheed Martins' competitive advantage is structural and durable. LMT's year end 2025 backlog of 193.6 billion represents a durable base of contracted revenue across: F-35, PAC-3/THAAD air defense franchise, and Sikorsky rotorcraft. The industry's structure and extreme barriers to entry ensure stable 10-13% operating margins and ROICs well above cost of capital. Our forecast of **10.7% exit**

operating margin and 30.9% CV year ROIC are supported by this structure.

Peer Comparisons

To evaluate Lockheed Martin's competitive positioning, we used the four closest large-cap defense peers in Northrop Grumman, RTX Corporation, General Dynamics, and L3Harris Technologies. It should be noted that we had initially used Boeing in our comparisons due to its large role within the industry, however, because of the notable turbulence in their financial restructuring, we believed that making a direct comparison would be misleading.

Gross Margins

Lockheed Martin's gross margins are the lowest among their competitors, with a posted margin of 10.15% compared to the average 15.42% as of 2025. As established in the cost structure, Lockheed Martin's low gross margin is attributed to classified fixed-price losses taken as forward losses rather than structural deterioration. L3Harris leads the group at 22.49% in 2025, reflecting its focus on electronics and software, which means L3Harris carries structurally lower input costs compared to hardware intensive firms. RTX follows at an operating margin of 20.08%, a number that is inflated by their commercial aerospace aftermarket margins. Northrop Grumman sits at 19.81% and General Dynamics at 15.13%, benefitting from Northrop's cost-plus program mix and General Dynamics Gulfstream's premium pricing. It is typical for defense industrials to have low gross margins because of strict government pricing and regulations. We attribute Lockheed Martin's lower gross margin to being a hardware intensive contractor alongside their forward losses.

ROIC and Capital Efficiency

As a note, we used FactSet's data to give a clearer comparison with their calculations rather than our own calculations which are different.

Lockheed Martin separates itself from its peers in its ROIC as they lead with a ROIC of 18.29%. against Northrop's 12.77%, L3Harris Technologie's 5.24%, RTX's 6.68%, and General Dynamics 12.95%. Lockheed Martin generates nearly double the return on its invested capital compared to the closest competitor. A key driver is through the government contracts allowing for Lockheed Martin to operate with minimal net working capital, compared to

the competitors who have a bigger commercial side. Lockheed's matured program provides a form of moat by creating a captive revenue stream. This gives Lockheed Martin the advantage of every dollar of growth creating more value compared to its competitors.

Invested Capital Turnover

Lockheed Martin's invested capital turnover is 1.85 and leads its peers. General Dynamics runs at 1.27, Northrop at 1.25, RTX at 0.67, and L3Harris at 0.49. As mentioned before, the gap can be explained in the government contract deals, with Lockheed Martin being less commercialized they benefit from no dilution through commercial sectors. Through these government contracts, Lockheed Martin is fundamentally being paid to grow.

Sustainability

Lockheed Martin's business model is structurally durable in the industrials sector with its competitive advantages entrenched through its position in the market. The dependence on the United States Government comes as a risk, however it can also be seen as a strength. Using the governments procurement framework, changing contractors is costly in nature, this gives Lockheed Martin a rather large margin of safety with its contracts. Because of this reasoning, Lockheed Martin's business model protects their position from competitors.

Forward Positioning

Among the peers, Lockheed Martin and Northrop are best positioned in the industrial market. Both have strong ROIC, substantial backlogs, and direct exposure to missile defense programs that are receiving elevated funding. The strongest driver for our forecast is in shifts towards high-volume munitions production. This trend favors Lockheed Martin with its PAC-3 MSE and THAAD missile interceptors. With a strong exposure to the missile defense market alongside posting the highest segment margin, we position Lockheed Martin at the front of their competition.

RECENT DEVELOPMENTS

Recent Earnings Announcement

Lockheed Martin reported Q4 2025 results on January 29, 2026, beating consensus on revenue, GAAP EPS, adjusted EBITDA, and free cash flow. 2025 sales of 75B grew 6% YoY, operating profit of 7.7B rose 10% and free

cash flow exceeded the company own prior guidance. The beat was driven by aeronautics sales up 6.4% on record F-35 deliveries (191 units in 2025), MFC record deliveries of 620 PAC-3 MSE interceptors, and operating margin recovery.

Our 2026 revenue of 79B and operating profit of 8.5B are essentially in line with the midpoints of management's guidance ranges. Our EPS of 29.41 is also in line with management's guidance range of 29.35-30.25.

Recent Development #1

On January 6, 2026, Lockheed Martin signed a seven-year framework agreement with the U.S Department of War to triple PAC-3 MSE annual production capacity from 620 until to 2,000 units annually. This is a landmark deal that represents the single largest capacity expansion in LMT's missile defense franchise.

Global PAC-3 demand surged after a combat proven performance in recent Middle East operations, and 17 partner nations have selected the system. The seven-year certainty shifts the PAC-3 program to a long term, high visibility growth franchise.

Impact on our forecast: We model MFC growing at 9.3% annually through 2030E reflecting PAC-3 ramp up plus, HIMARS, GMLRS, and JASSM.

RISKS

Customer and Program Concentration

Lockheed Martin's revenue is concentrated on a small number of customers and a single flagship program exposing the company to policy level and program level shocks. 72% of 2025 revenue came from the U.S government, including 63% from the Department of War. Additionally, The F-35 program alone represented 27% of 2025 consolidated sales and 67% of aeronautics segment sales. A reduction in the annual F-35 procurement rate or a further Block 4 software delay would cause a direct hit on Lockheed's earnings.

Fixed Price Contract Structure and Classified Write Downs

Since 2018, the Department of War has shifted away from cost plus contracts where the government absorbs cost overruns toward fixed price contracts where the prime

bears all overrun risk. This has produced approximately 4 billion in pretax reach forward losses for LMT over 2023-2025. Our forecast presents a conservative 89.4% COGS ratio, but a fourth consecutive year with a write down would compress our margins and lower our overall valuation of the company.

Defense Budget and Political Volatility

Our revenue growth assumptions at the segment level depend on the U.S budget reaching 1.5T by 2027. LMT's 2026 guidance explicitly excludes potential government shutdown impacts on the company. Contract awards would be delayed, and cash payments would slow down. Administration changes in 2028 could reverse budget trajectory. The current administration has prioritized defense, but different policies could compress the defense budget growth assumptions.

Platform Competition Losses

Defense primes are driven by winning large platform competitions, each win creates a long-lasting revenue stream. LMT lost the NGAD/F-47 sixth generation fight to Boeing in March 2025. This caps long term aeronautics growth rate of the F-35 if the F-47 succeeds in air superiority roles. Near terms cash flows would be unaffected as F-35 sustainment will remain a relevant cash flow for Lockheed Martin during our forecast period. However, implications like this could impact the CV growth rate of NOPLAT therefore reducing our DCF valuation.

Debt Maturity Analysis

Lockheed Martin has \$22.9B in gross debt consisting entirely of notes and bonds. Notably, 56% of their debt matures after 2036 meaning the near-term burden is manageable (10). With Lockheed Martin's management prioritizing capital returns over deleveraging, we expect the firm to continue refinancing the debt. This is supported by the firm issuing \$5B in new bonds across 2024-2025 extending the firm's obligation to pay. Lockheed Martin will have enough cash accumulated using these previous issuances alongside their free cash flows to pay off the near-term debts. We forecast that Lockheed Martin will be able to continue issuing long-term debt for refinancing issues with low chances of liquidity risks in the near future.

Five-Year Debt Maturity Schedule

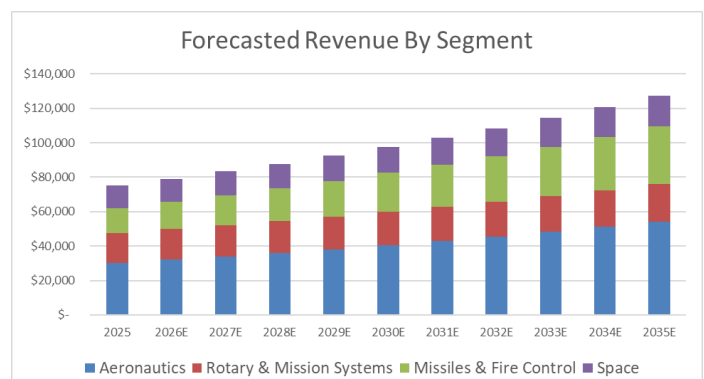
| Fiscal Year | Coupon (%) | Payment (\$mil) |
|--------------|------------|-----------------|
| 2026 | 5.650% | \$1,168.4 |
| 2027 | 5.100% | \$750 |
| 2028 | 4.300% | \$1,000 |
| 2029 | 6.500% | \$833 |
| 2030 | 3.125% | \$1,150 |
| Thereafter | 4.769% | \$18,012.6 |
| Total | | \$22,914 |

Source: FactSet

VALUATION

Revenue Growth Assumptions

We forecast revenue growth of approximately 5% annually over a 10-year period based upon our segment forecasting using Lockheed's strong backlog visibility. Aeronautics remains the largest revenue driver with the steady production of F-35's supported by deep backlogs through continued deliveries and sustainment revenue to drive a 6% annual growth. Our Rotary & Mission Systems is projected out with a 2.3% growth rate following the forward losses on the Blackhawk program, also reflecting a mature segment. Lockheed Martin's Missile & Fire Control is the fastest growing at 9% reflecting the elevated global demand for missile defense systems, munition replenishments, and hypersonic programs in response to geopolitical tensions. Because of set contract deals set out to 2030, we forecast the segment to taper down to 8% as the segment's revenue drivers begin to mature. Finally, the Space segment is forecasting a steady growth of 3% driven by stable programs like Orion and Trident II D5 ballistic missiles.



Operating Expense and Margin Assumptions

We model operating expenses at the segment level using each segment's 10-year historical average cost ratio, then aggregate to a single consolidated cost of sales line. This approach captures each segment's distinct cost profile rather than a blended consolidated assumption.

Aeronautics: Segment expense modeled at 90% of segment sales. The margin compression in 2024-2025 (93% in 2025) reflects classified program charges that we don't extrapolate indefinitely but keep margins lower than they were at their peak.

Rotary and Mission Systems: 91% of segment sales. Sikorsky helicopter mix (CMHP, TUHP overruns) keep this segment structurally lower margin than Aeronautics and MFC.

Missiles and Fire control: 87% of segment sales. This is LMT's highest margin segment and grows the fastest in our forecast (due to contract awards), so favorable mix lifts blended COGS modestly over time.

Space: 90% of segment sales. Space is LMT's smallest segment at 17% of 2025 revenue, organized around three stable buckets: Strategic and Missile defense systems, National security space, and commercial civil space (primarily NASA's Orion crew capsule). The diversified program mix and absence of major classified write downs have kept Space cost ratio relatively stable. Managements 2026 guidance of slightly above 10% margin in very closely aligned with our 90% cost assumption. (7)

Aggregated up, the segment level assumptions produce a consolidated cost of sales of 89.4% of total revenue in 2026. This is a conservative posture; we are not modeling a return to 2018-2021 margins because classified fixed price charges have happened in three consecutive years (2023-2025) generating 4B in pretax reach forward losses.

This produces gross margin expansion from 10.2% (2025) to 10.6% (2035) and operating margin expansion from 10.3% to 10.7% (44 bps). The expansion is driven primarily by MFC mix shift, because MFC grows at 9.31% until 2030 and then 8.16% until 2035. Additionally, MFC carries the lowest cost ratio of the four segments leading to a modest improvement of COGS ratio over the forecast period.

Capital Expenditure Assumptions

We model capex at 2.2B in 2026 rising to 2.8 by 2035. This is slightly below management's guidance range of 2.5-

2.8B. Management guided a 35% step function increase to support PAC-3 MSE capacity production increase from 600 to 2000 units a year. This holds fixed capital at approximately 12.7% of next year's revenue throughout the forecast period. The step-up function is forecasted to absorb overtime as new capacity converts to revenue.

Earnings Estimates

Our 2026 estimates for diluted EPS sits at \$29.37 which is right in line with managements guidance of \$29.35-\$30.25 range. Our estimates also fall under the more conservative side compared to analysts at Bloomberg who estimate 2026's EPS at \$29.89. While there is strong demand for Lockheed Martin, the company is experiencing issues in execution which can be seen in their recent quarterly report where the firm missed earnings and revenue by slightly underperforming. The company also reported a free cash flow loss of \$291M in the first quarter of 2026 justifying our conservative outlook (8).

Capital Structure Assumptions

Our model assumes a pretax cost of debt of 5.37%, consistent with Lockheed Martin's current borrowing rates. Long-term debt has grown modestly in line with management guidance. The firm maintains an investment grade credit rating and we forecast the companies leveraging to remain stable.

Share repurchases remain an integral component of Lockheed Martin's capital structure. Our model tracks the firms share repurchases as a percent of net income, with our model predicting share repurchases at 50% of the net income. This is a conservative estimate compared to the 10-year historical average of 65.5%, supported by the lack of share repurchases in quarter one of 2026 compared to 2025's \$750M share repurchase.

Payout Policy Assumptions

We forecast dividends as 50% of the net income throughout our forecasting period, consistent with Lockheed Martin's historical payout ratio. We forecast a dividend payout of \$3.28B, in line with last years payment of \$3.13B. We believe this assumption is reasonable in that it allows dividends to grow alongside earnings, and it reflects Lockheed Martin's position as mature defense contractor with high payout ratios.

Contingent Liabilities

The most significant contingent liability in our forecasting is Lockheed Martin’s pension obligations. We forecast accrued pension liabilities rising to \$6.6B in 2026 driven by our assumption that they will increase back to the average levels from 2021-2024. This represents a meaningful re-accrual following several years of pension de-risking.

Another concern raised in our forecasting is in the delivery of the F-35 program. Lockheed Martin has reported being approximately \$1B over the set budget. With the largest revenue driver being the F-35 program, it is essential for Lockheed Martin to maintain its negotiated deliveries.

Valuation Model Results

Our DCF model implies a price of \$654.46 per share, and our EP model implies a price of \$650.78. The convergence of our valuations strengthens our position in our position showing consistency. The key inputs we used in our models are a WACC of 6.67, a CV growth rate of 2.5%, and a CV year ROIC of 40%. We derived our WACC using a 5-year adjusted beta of 0.567 from Bloomberg. The difference between the models comes from adding back the invested capital. We place greater confidence in the DCF model because of a strong visibility in Lockheed Martin’s backlogs, and in our calculations for NOPLAT being insulated from the volatility of the government contract structure.

| | | CV Growth of NOPLAT | | | | | | | |
|--------------|--------|---------------------|--------|--------|--------|--------|--------|--------|-------|
| | | 418.85 | -3.00% | -2.00% | -1.00% | 0.00% | 1.00% | 2.00% | 3.00% |
| CV Year ROIC | 25.00% | 389.99 | 411.52 | 438.67 | 473.95 | 521.68 | 589.84 | 695.12 | |
| | 27.50% | 387.21 | 409.45 | 437.50 | 473.95 | 523.26 | 593.67 | 702.44 | |
| | 30.00% | 384.89 | 407.73 | 436.53 | 473.95 | 524.58 | 596.87 | 708.54 | |
| | 32.50% | 382.93 | 406.28 | 435.70 | 473.95 | 525.69 | 599.57 | 713.70 | |
| | 35.00% | 381.25 | 405.03 | 435.00 | 473.95 | 526.64 | 601.89 | 718.13 | |
| | 37.50% | 379.80 | 403.95 | 434.39 | 473.95 | 527.47 | 603.90 | 721.96 | |
| | 40.00% | 378.53 | 403.00 | 433.85 | 473.95 | 528.20 | 605.66 | 725.31 | |

The sensitivity table test CV year ROIC against CV Growth of NOPLAT, and the results confirm our buy thesis is based on the durability of terminal growth. The effect of NOPLAT growth is much greater than that of ROIC, meaning that Lockheed must maintain a level of growth around 2% or higher. Our model assumes a CV growth of around 2.5% for reference. A clear risk that would drive down our growth rate is if the recent weapons procurements would be cyclical in nature rather than structural.

| | | WACC | | | | | | | |
|--------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| | | 647.43 | 6.00% | 6.50% | 7.50% | 8.50% | 9.50% | 10.50% | 11.50% |
| CV Year ROIC | 25.00% | 785.95 | 669.64 | 507.60 | 400.39 | 324.42 | 267.91 | 224.33 | |
| | 27.50% | 792.77 | 675.33 | 511.75 | 403.54 | 326.88 | 269.88 | 225.93 | |
| | 30.00% | 798.45 | 680.07 | 515.20 | 406.16 | 328.93 | 271.52 | 227.26 | |
| | 32.50% | 803.26 | 684.08 | 518.13 | 408.38 | 330.67 | 272.90 | 228.39 | |
| | 35.00% | 807.37 | 687.52 | 520.63 | 410.28 | 332.16 | 274.09 | 229.35 | |
| | 37.50% | 810.95 | 690.50 | 522.80 | 411.93 | 333.45 | 275.12 | 230.19 | |
| | 40.00% | 814.07 | 693.11 | 524.70 | 413.38 | 334.58 | 276.03 | 230.92 | |

The WACC sensitivity table tests the CV year ROIC against the WACC, and it shows the WACC having the greatest direct impact on our valuation. Our base value is a WACC of 6.67%, showing that a 1% increase in WACC would decrease our valuation by approximate \$140. This means our buy thesis has a narrow WACC tolerance. Political uncertainty in capital allocation could upend the margin of safety destroying value for the firm.

| | | Aeronautics Sales Growth | | | | | | | |
|---------------------|--------|--------------------------|--------|--------|--------|--------|--------|--------|--------|
| | | 647.43 | 4.00% | 5.00% | 6.00% | 7.00% | 8.00% | 9.00% | 10.00% |
| CV Growth of NOPLAT | -3.00% | 363.7 | 373.57 | 384.16 | 395.52 | 407.73 | 420.83 | 434.88 | |
| | -2.00% | 385.07 | 395.73 | 407.19 | 419.49 | 432.72 | 446.92 | 462.15 | |
| | -1.00% | 412.00 | 423.67 | 436.22 | 449.70 | 464.22 | 479.81 | 496.54 | |
| | 0.00% | 447.01 | 459.99 | 473.95 | 488.98 | 505.16 | 522.56 | 541.24 | |
| | 1.00% | 494.35 | 509.10 | 524.99 | 542.10 | 560.54 | 580.38 | 601.70 | |
| | 2.00% | 561.96 | 579.25 | 597.88 | 617.97 | 639.63 | 662.95 | 688.05 | |
| | 3.00% | 666.41 | 687.60 | 710.48 | 735.16 | 761.79 | 790.50 | 821.42 | |

The aeronautics and NOPLAT growth sensitivity table tests the CV Growth of NOPLAT, and it shows that terminal growth is the dominant value driver. We have a base of 2.5% NOPLAT growth and aeronautics growth at 6%. The table shows that the recent issues with the F-35 deliveries and expenses are not a make or break for our valuation if they can maintain around a 2-3% growth of NOPLAT. However, if the F-35 execution problems are severe enough to compress earnings in the long-term, then a fall in NOPLAT growth would drastically reduce share valuations.

| | | Missiles and Fire Control Sales Growth | | | | | | | |
|---------------------|--------|--|--------|--------|--------|--------|--------|--------|--------|
| | | 647.43 | 6.31% | 7.31% | 8.31% | 9.31% | 10.31% | 11.31% | 12.31% |
| CV Growth of NOPLAT | -3.00% | 369.26 | 374.05 | 379.02 | 384.16 | 389.48 | 394.99 | 400.71 | |
| | -2.00% | 391.20 | 396.34 | 401.67 | 407.19 | 412.90 | 418.82 | 424.95 | |
| | -1.00% | 418.85 | 424.44 | 430.23 | 436.22 | 442.42 | 448.85 | 455.52 | |
| | 0.00% | 454.80 | 460.96 | 467.34 | 473.95 | 480.80 | 487.89 | 495.24 | |
| | 1.00% | 503.43 | 510.36 | 517.55 | 524.99 | 532.71 | 540.70 | 548.98 | |
| | 2.00% | 572.86 | 580.91 | 589.24 | 597.88 | 606.83 | 616.11 | 625.72 | |
| | 3.00% | 680.13 | 689.88 | 699.99 | 710.48 | 721.34 | 732.60 | 744.27 | |

The NOPLAT and Missiles & Fire Control growth table reflects that the Growth of NOPLAT is the once again the largest driver of value growth. With the base of 2.5% NOPLAT growth alongside 9.31% in Missiles & Fire Control, our table shows that increased growth in the segment can

lead to a better margin of safety. However, continued growth in NOPLAT is the more important catalyst for value growth. A clear risk to Lockheed Martin is the rapid de-escalation of conflicts resulting in reduced demand for the MCF segment, driving its growth back to normal levels and over the long-term decreasing growth of NOPLAT.

Conclusion

We initiate coverage of Lockheed Martin with a BUY rating reflecting on a strong opportunity within the market. As our valuation appears in line with outside consensus at a DCF value of \$647.43 per share, we believe the stock is currently undervalued. While the market reacts to recent news of Lockheed Martin's first quarter underperformance, we believe that their fundamentals and overall firm structure remains sound.

With a strong visible backlog in future cash flows, an environment with a larger emphasis on defense, and a proven capital framework delivering consecutive years of sustained dividend growth, we believe that the current price at \$513.45 as a compelling entry point created by short term noise within the market.

KEYS TO MONITOR

Bull Case

Our Bull scenario is if Lockheed Martin can normalize their F-35 delivers, further increases in global defense spending, and a continued political support for defense spending. This would look like LMT delivering 45-50 aircraft per quarter, closing the EPS gap to meet the set guidance, and global organization like NATO committing to spending 2.5% of GDP of defense at the June summit.

Bear Case

Potential downsides to this investment is the loss of the next major platform such as NGAD, as well as the de-escalation of global tension leading to a reduced growth in defense spending. As NGAD development, we could see a drastic reduction in the procurement and sales of the F-35 program, Lockheed Martin's largest revenue catalyst. Currently Missiles & Fire Control is driven by increased demand for missile defense systems, seeing a rapid de-escalation in geopolitical conflicts could harm this growth.

Our positioning remains a BUY, Lockheed Martin's recent market developments present a strong opportunity for

profit. If the markets pricing increases to \$580-\$600 then we would reduce our valuation to a HOLD.

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