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Siena Market Line
2sd week of April 2016

Orbital ATK, Inc.

NYSE:OA

Analyst: Pierre Riffard
Sector: Industrials

BUY

Price Target: $104

Key Statistics as of 04/08/2016

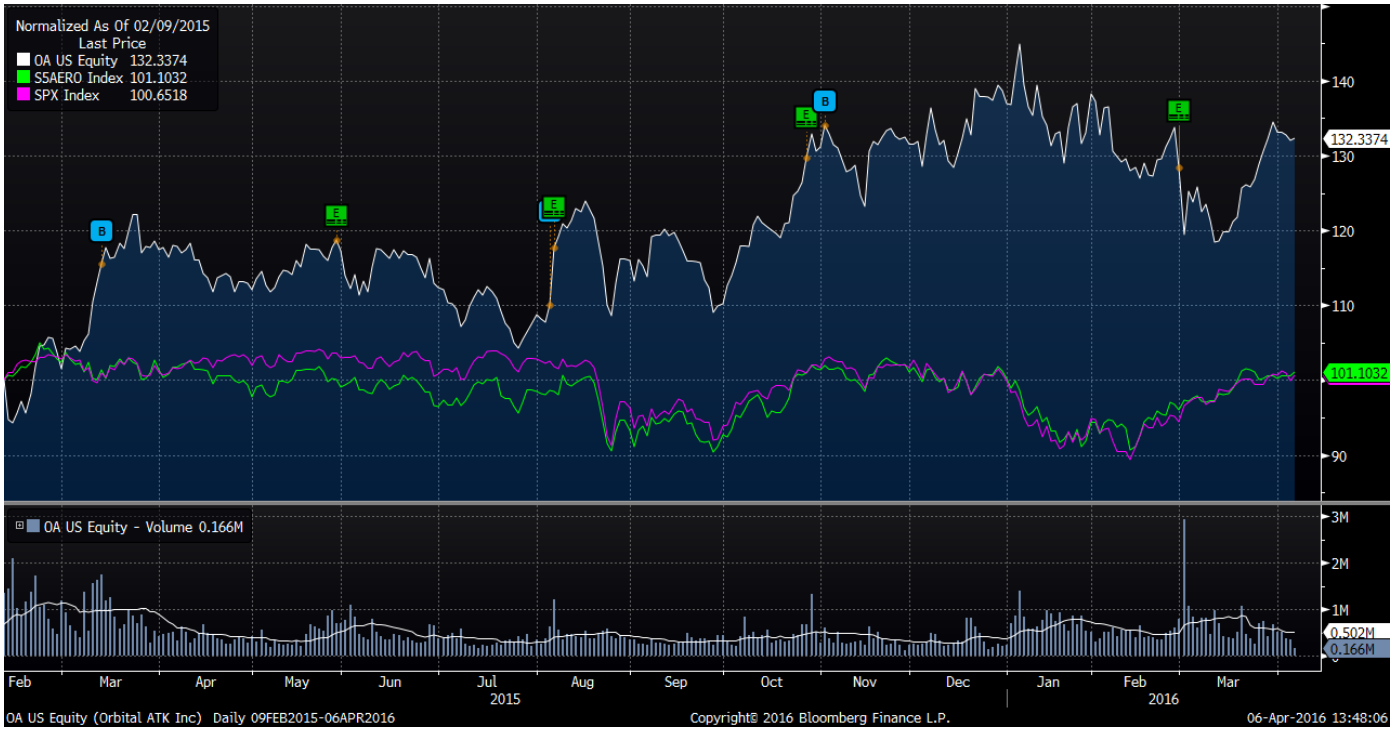
Market Price:	$86.91
Industry:	Aerospace & Defense
Market Cap:	$5.097B
52-Week Range:	$56.06 - $94.92
Beta:	0.94

Thesis Points:

- 2015 merger will bring opportunities for faster growth, increased profitability, and cost synergies.
- Strong future cash generation will enable value to shareholders, and improve liquidity.
- Start of three major growth investments.
- Favorable industry outlook based on current and expected geopolitical situation.

Company Description:

Orbital ATK, Inc. (NYSE:OA) is a global Aerospace & Defense company, headquartered in Dulles, VA. The company is divided in three groups: Flight Systems, Defense Systems, and Space Systems. It is engaged in the development and manufacturing of advanced weapon and space systems including flight systems, rocket propulsion systems, aerospace structures, tactical missile systems, commercial and government satellites, ammunitions and energetics, armament systems, and defense electronic systems. Over FY2015, the company employed on average 12,000 employees throughout the U.S.A, Saudi Arabia, the UAE, and Singapore. OA is the leading producer of solid rocket propulsion systems, the largest manufacturer of small- and medium-caliber ammunition, the primary supplier of long-range missile defense interceptors and target systems, a major builder of satellites, the principal supplier of medium-caliber gun systems for U.S. and NATO, the leading operator of small research rockets and high-altitude scientific balloons, and is operating of the largest U.S. ammunitions manufacturing facility.

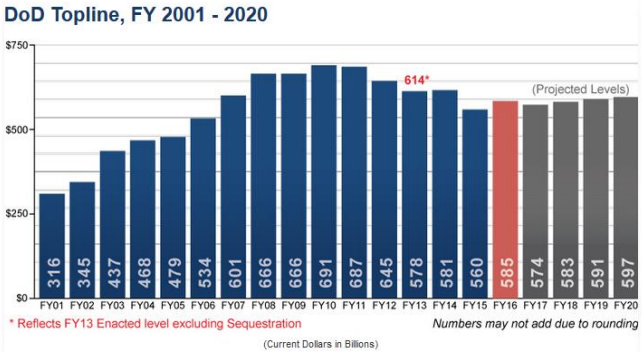


Thesis

Orbital ATK just completed its first fiscal year of operations after its 2015 merger. Since then, the new company proved it achieved even more synergies than targeted and is planning on even more cost reductions and revenue growth over 2016 and beyond. Knowing that the company is already placing itself among the top industry performers in term of efficiency, and that there is still room for improvement thanks to the merger, the stock may continue to outperform and bring more capital returns as the price will adjust to the new financial results and expectations. Its improving cash generation will improve and enable a lot of value to shareholders via increasing dividends and share repurchase program. Furthermore, the company is going to invest in 2016 in three major growth investments in each of OA's segments to solve the slow growth in sales, and is expected to bring huge returns on investments. Then, the current geopolitical situation, where the military expenditures of every key nations are increasing, and where the terrorist threats is becoming more and more present, will positively affect the Aerospace & Defense Industry. Given all those reasons, OA is in a very good position to grow and gain more and more interests from investors.

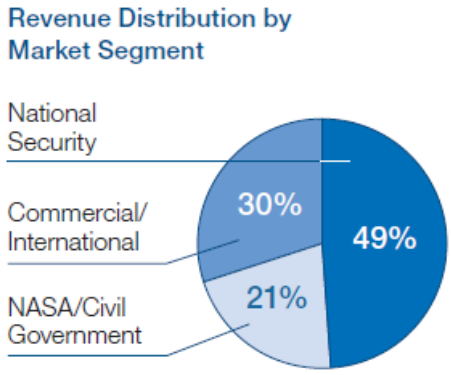
Industry Outlook

The Aerospace & Defense revenue is mostly dependent on the American defense budget. It remains constrained by the 2011 Budget Control Act, which reduced the DoD budget by approximately $490 billion over ten years. In 2015, the Bipartisan Budget Act set base budgets in excess of the limits that would have been imposed by the Bipartisan Budget Act. The defense budget is now forced to rise again due to the resurgence of international threats. The 2016 Budget is set at $585 billion, which corresponds to the first increase since 2010, and a 4.5% increase Yoy. The budget outlook for defense and space spending for 2016 is generally positive as described in the 2015 annual report[1]. The investment levels of the 2016 DoD budget, including research and development and procurement funding, increased by 15%. The missiles and munitions budget went up by 20%, and a 7% increase has been requested for 2017. The small-, medium-, and large-caliber ammunition budget went up by 40% in 2016, and is forecast to grow at 10% for 2017.



According to Deloitte[2], the industry revenue is expected to grow at 3% in 2016 as military budgets in the US, UK, France, Japan, several Middle Eastern countries, and other key nations are increasing in response to growing threats around the world like the recent terrorist attacks in Paris and Brussels. The defense budget of Saudi Arabia, which is an important OA's customer, increased by 12% Yoy. Another very important customer is NASA, whose budget increased by 7% between 2015 and 2016. Other large customers include Boeing, Northtrop Grumman, Lockheed Martin, Airbus, Raytheon, Rolls-Royce and Thales.

	Percentage of Sales		
	Nine Months Ended December 31, 2015	Years Ended March 31, 2015	Years Ended March 31, 2014
Sales to:			
U.S. Army	15%	27%	33%
U.S. Navy	11	15	16
NASA	23	13	14
U.S. Air Force	4	6	7
Other U.S. Government customers	17	14	14
Total U.S. Government customers	70	75	84
Commercial and foreign customers	30	25	16
Total	100%	100%	100%



CY 2015 Adjusted Revenue Distribution

One major event that may impact the industry is the US political election. If the next president is the republican nominee, the chance to see a huge rise in the defense budget is very high. On the other hand, if the democrat nominee wins the election, the chance to see the

[1] http://phx.corporate-ir.net/phoenix.zhtml?c=81036&p=irol-IRHome

[2] http://www2.deloitte.com/global/en/pages/manufacturing/articles/global-a-and-d-outlook.html

defense budget diminish is very low. Even if the next president is willing to stop the rise in military expenditures, the current situation made it impossible. As the terrorist threat is growing and as the defense budget of non-allies states are expanding, the US are forced to at least expand their budget by at least 1% to 2% over the next years.

Product Portfolio

OA is divided into three main groups that are divided into several divisions.

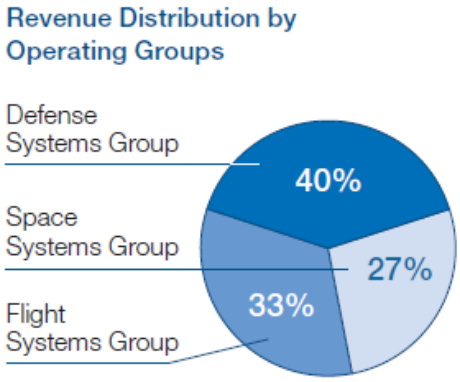
Flight Systems Group is developing rockets that are used as small- and medium-class vehicles to place satellites into orbit and escape trajectories, interceptor and target vehicles for missile defense systems and suborbital launch vehicles that are place payloads into a variety of high-altitude trajectories. It is also engaged in the development and production of medium- and large-class rocket propulsion systems for human and cargo launch vehicles, strategic missiles, missile defense interceptors and target vehicles. The Group develops other products like illuminating flares and aircraft countermeasures. The Group sales accounted for 33% of 2015 total sales. It operates three divisions: Launch Vehicles, Propulsion Systems, and Aerospace Structures.

Defense Systems Group develops and produces small-, medium-, and large-caliber ammunition, precision weapons and munitions, high-performance gun systems, and propellant and energetic materials. It also provides propulsion control systems that support Missile Defense Agency and NASA programs, airborne missile warning systems, advanced fuses, and defense electronics. The Group is a leader in tactical solid rocket motor development and production for air-, sea- and land-based missile systems. It is responsible of the production of the US Navy's Advanced Anti-Radiation Guided Missile or AARGM and has developed advanced air-breathing propulsion systems and special-mission aircrafts. The Group sales accounted for 40%. The Group is operating four divisions: Armament Systems, Defense Electronics, Missile Production, and Small Caliber Systems.

Space Systems Group is engaged in the development and production of small- and medium-class satellites that are used to enable global and regional communications and broadcasting, conduct space-related scientific research, and perform other activities related to national security. It also develops and produces human-rated space systems for Earth-orbit and deep-space exploration, including delivering cargo to the ISS. The Group is also a provider of spacecraft components and subsystems and specialized engineering and operations services to US agencies. The Group sales accounted for 27% of 2015 total sales. It operates four divisions: Government Satellites, Commercial Satellites, Space Components, and Technical Services.

Sales

	Nine Months Ended			
	December 31, 2015	December 28, 2014	$ Change	% Change
	(unaudited)			
Flight Systems Group	$ 1,139,733	$ 766,132	$ 373,601	48.8%
Defense Systems Group	1,333,997	1,395,901	(61,904)	(4.4)
Space Systems Group	973,481	222,635	750,846	337.3
Corporate and Eliminations	(48,122)	(180,240)	132,118	(73.3)
Total sales	$ 3,399,089	$ 2,204,428	$ 1,194,661	54.2%



CY 2015 Adjusted Revenue Distribution

Financials

Over 2015, OA achieved record sales, profits, and free cash flow, and it returned $133 million (or 46% of free cash flow) to shareholders via stock repurchase and dividends. The company is planning on repurchasing between $125-175 million of stocks, increasing dividends by more than 52% to $70 million for FY2016. Repurchase and dividends are expected to account for 60-70% of free cash flow over the next years. OA is also planning on paying back $40 million of debt (or 5% of long-term debt). Capital expenditures are expected to double to reach $215 million in 2015 to prepare future expansion and growth.

In 2015, the operating margin of the company was 11.1%. The company expect to see improvement in efficiency due the merger's synergies completion. Sales, operating margin, and free cash flow are expected to grow over FY2016. Even if the expectation in sales growth has been reduced to 3-4%, it is still better than the 3% expected growth of the industry, and the new 2016 growth investments' main goal is to boost long-term sales growth. The EBITDA margin is expected to grow at 8-10%, so much more than the forecast sales growth.

Segment / Full Year	Revenues	Operating Income	Operating Margin
Flight Systems	$1,506	241.1	16.0%
Defense Systems	1,836	190.4	10.4%
Space Systems	1,260	98.3	7.8%
Corporate	(87)	(30.1)	N.A.
Consolidated	$4,515	499.7	11.1%

2016 Financial Guidance Orbital ATK

- Revenue and Margin Outlook by Segment and Consolidated ($ Millions)

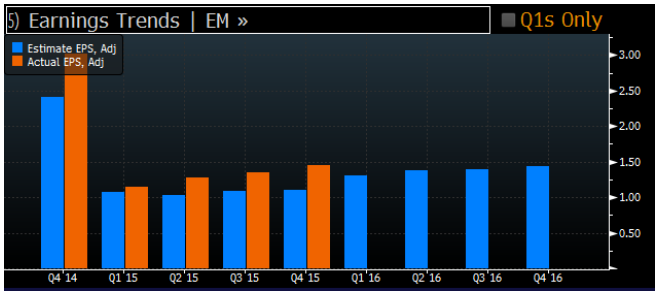
Segment	Revenue Range	EBIT Margin Range
Flight Systems	$1,525 – $1,555	13.0% – 13.5%
Defense Systems	$1,870 – $1,900	10.0% – 10.5%
Space Systems	$1,260 – $1,290	9.0% – 9.5%
Corporate / Other	($80 – $100)	0.5% – 1.0%
Consolidated	$4,575 – $4,650	11.0% – 11.5%

- Earnings per Share ~$5.25 – $5.50
- Free Cash Flow ~$275 – $325 Million
- GAAP Tax Rate ~32%
- Average Share Count ~58 Million

2015-2017 Financial Targets vs. 2015 Results* Orbital ATK

- Revenue Growth ~4-5% CAGR (Reduced to ~3-4%) — 2015 Result ~2%
- EBITDA Growth ~8-10% CAGR — 2015 Result ~15%
- EPS Growth ~12-15% CAGR — 2015 Result ~20%
- Cumulative Free Cash Flow ~$1 Billion — 2015 Result ~$290 Million
- Cost Synergies by 2016 ~$70-100 Million — 2015 Result ~$80 Million
- Revenue Synergies by 2016 ~$150-200 Million — 2015 Result ~$70 Million

Over the last year, OA had beaten its own forecast in terms of cost and revenue synergies, total sales, operating margin and free cash flow. Over the past seven earnings calls, the company beat all the EPS estimates, 6 of 7 operating profit estimates, and 5 of 7 revenue estimates.



Competitors

When compared to the overall industries, OA is achieving better results than the industry average and median. Its 14.8% EBITDA margin is better than the 13.5% industry median, achieving more cost reductions. Its profit margin is above the industry average and in line with the median, and its free cash flow margin is more than 1% higher than the industry average and in line with the median. Regarding the valuation ratios, we can see that the EV/EBITDA ratio is in line with the median but lower than the average, and the EV/Sales ratio is lower than the median and well lower than the average. Only based on such ratios, OA seems to be currently underpriced. That may be explained by the fact the company just completed its first full year of operations since the merger with better-than-forecast financial results and future improvements that are not totally priced yet.

Name (BICS Best Fit)	EBITDA to Net Sales:Y	Sales Gr T12M	PM:Y	EV / EBITDA Adj:Y	EV/Sales T12M:D-1	Dvd Yld:Y	FCF Margin
Median	13.48%	12.80%	7.05%	8.75	1.86	0.75%	3.93%
Average	14.04%	9.92%	6.52%	10.57	2.75	1.26%	5.31%
100)ORBITAL ATK INC	14.83%	16.90%	7.05%	8.75	1.47	0.77%	5.07%
101)AEROSPACE INDUSTRI...	13.48%	7.84%	7.55%	--	1.74	--	5.01%
102)BAE SYSTEMS PLC	11.03%	8.79%	5.47%	9.40	1.01	4.18%	1.89%
103)CHEMRING GROUP PLC	11.37%	12.80%	1.80%	8.44	1.42	1.40%	1.51%
104)CHINA AEROSPACE TIM...	10.28%	14.42%	4.74%	--	2.89	0.56%	-5.48%
105)JIHUA GROUP CORP LT...	3.38%	-16.77%	5.28%	--	1.54	0.72%	-6.51%
106)MSA SAFETY INC	13.79%	-0.63%	7.09%	11.56	1.86	2.92%	1.68%
107)NORTH NAVIGATION C...	10.34%	18.10%	2.03%	--	9.70	0.20%	3.93%
108)SMITH & WESSON HOL...	21.84%	26.14%	9.28%	7.63	2.01	0.00%	15.69%

(Accounting adjustments: Adjusted for abnormal items, when applicable) 10 Analyze List

2015 Merger Results

On April 30, 2014, Alliant Techsystems announced a merger of equals with Orbital Sciences. Alliant Systems was a leader in manufacturing ammunitions, rockets, and rocket ships and Orbital Sciences was a small- and medium-class space and rocket systems manufacturer. Alliant had first spin-off its sporting goods business as a separate publicly traded company: Vista Outdoor (NYSE:VSTO). Then, Alliant merged with Orbital into a global aerospace & defense company: Orbital ATK (NYSE:OA). Alliant and Orbital shareholders received 53.8% and 46.2% respectively of OA shares. On April 28, 2014, both companies' shareholders strongly approved the tax-free merger. 99% of Orbital's votes approved the merger, which represented 85% of the total number of shares outstanding[3]. As a result, the stock of Alliant and Orbital went up by 7% and 16.5% respectively[4]. The merger was completed on February 9, 2015. According to the latest annual report[5], 95% of the 1,350 pre- and post-merger integration milestones were already completed by the end of 2015. The primary objectives of the merger was to expand career opportunities, increase job stability, and to boost long-term investment. The merger is creating lots of growth opportunities and cost synergies. The achieved synergies in 2015 exceeded the company's targets. OA achieved over $80 million in cost reductions, and is on

3 http://www.streetinsider.com/Management+Comments/Orbital+Sciences+%28ORB%29+Shareholders+Approve+Alliant+Techsystems+%28ATK%29+Merger/10197749.html

4 http://www.fool.com/investing/general/2014/04/30/introducing-orbital-atk-the-next-big-thing-in-spac.aspx

5 http://phx.corporate-ir.net/phoenix.zhtml?c=81036&p=irol-IRHome

track to reduce costs by an additional $100 million over 2016. It also achieved $70 million in revenue synergies in 2015 and is targeting from $150 to $200 million for 2016. In other words, the merger is on the right path to achieve even more synergies over the next few years, by reducing costs and maximizing both its bottom-line and top-line growth. Over the last fiscal year, OA hired 1,300 employees including engineers and scientists to prepare future growth. The fact the company hired the equivalent of 11% of its total employees is sending the sign of a strong activity ready to grow at a faster pace.

Merger Integration Update Orbital ATK

- Two Legacy Companies Now Operating as a Single Unified Enterprise
  - Smooth Transition to New Organizations, Systems and Processes
  - About 95% of 550-Plus Post-Closing Milestones Completed to Date
- Achieved ~$80 Million in Cost Synergies in 2015 and Targeting Over $100 Million of Savings in 2016
  - Reduced Corporate G&A and IT Costs ~$35 Million
  - Reduced Business Unit Costs (Facilities, Supply Chain, Etc.) ~$45 Million
- Achieved ~$70 Million in Revenue Synergies in 2015 and Targeting $150-200 Million in 2016 and Beyond
  - Four Major Merger-Enabled Contracts Valued at ~$700 Million Recently Booked
  - Good Prospects for More Orders Over Next 6-9 Months

New Major Growth Investments

In 2016, the company will start three major new growth investments in each OA's segments. The primary objective of these investments is to improve top-line growth on the long run. These initiatives capitalize on the technological advantage and market knowledge of the company and are responsive to well-understood needs on which OA has worked closely with its customers. The investments are expected to generate between $400-500 million in incremental annual revenue by the end of 2019. Dave Thompson, the CEO of the company, highlighted during the latest earning call[6], that the project internal rates of return range from the upper teens to almost 30%, which is well above its 9% cost of capital (as computed in my pro-forma) and that the investments will not impact the "vigorous" program of capital returns to the shareholders.

The first investment concerns the *Defense Systems Group*: it consists of a three-year program to develop an advanced ammunition and related small munitions with unmatched precision features. It extends on the technological advancements in guided ammunition, precision artillery and mortar rounds, and electronic fusing. OA will soon release initial versions of new weapons capabilities that are compatible with various calibers on ground, sea, and air platforms. Initial deliveries are expected to begin in the first half of 2018.

The second investment concerns the *Flight Systems Group*: it is a four-year program, jointly funded with the US Air Force, to develop a modular vehicle system or EELV (Evolved Expendable Launch Vehicle) capable of launching national security payloads, scientific and commercial satellites. The company expect the first launches by the end of 2019. The program may start to generate revenues as soon as the end of 2017.

The third investment concerns the *Space Systems Group*: the program is intended to develop the first in-space commercial satellite servicing system. The company expect to start the first operations at the beginning of 2019.

Conclusion

Orbital ATK is just starting to use and to see the impact of its merger on its financials, but also in its competitive advantages including its expertise, technological advance, and innovative solutions. OA is expected to improve its long-term growth with three major investments that are going to bring actual revenue as soon as the end of 2017 or beginning of 2018, but as the programs are starting this year, the company will be able to release updates during the next earning calls and investors will be able to act accordingly. The company will continue to improve its free cash flow along with its share repurchase program and dividends to return 60-70% of its free cash flow to shareholders. The long-term debt is expected to go down. Furthermore the current and expected geopolitical situation is making defense companies part of the least risky assets by securing their future growth. OA is among the best performer of the industry with huge potential for growth over the long-run. The pro-forma computed an intrinsic value of $87.76, and a one-year target of $104 (or a 21% rise), so I recommend a buy below $89.

[6] http://phx.corporate-ir.net/phoenix.zhtml?c=81036&p=irol-IRHome

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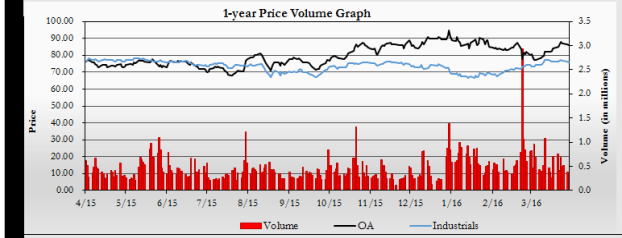
Siena Market Line
2sd week of April 2016

Orbital ATK, Inc. (OA)

CENTER FOR GLOBAL FINANCIAL STUDIES

BULLISH

Analysis by P.C. Principal	Current Price:	$86.91	Intrinsic Value	$87.76	Target 1 year Return: 21.4%
4/8/2016	Divident Yield:	1.2%	Target Price	$104.47	Probability of Price Increase: 95.6%



Description

Orbital ATK, Inc. develops and produces aerospace, defense, and aviation-related products to the U.S. Government, allied nations, prime contractors, and other customers in the United States and internationally.

General Information

Sector	Industrials
Industry	Aerospace and Defense
Last Guidance	November 3, 2015
Next earnings date	May 2, 2016
Estimated Country Risk Premium	6.81%
Effective Tax rate	36%
Effective Operating Tax rate	45%

Market Data

Market Capitalization	$5,096.54
Daily volume (mil)	0.26
Shares outstanding (mil)	58.64
Diluted shares outstanding (mil)	59.92
% shares held by institutions	88%
% shares held by investments Managers	74%
% shares held by hedge funds	8%
% shares held by insiders	1.18%
Short interest	2.06%
Days to cover short interest	0.00
52 week high	$94.92
52-week low	$56.06
Levered Beta	1.14
Volatility	44.05%

Past Earning Surprises

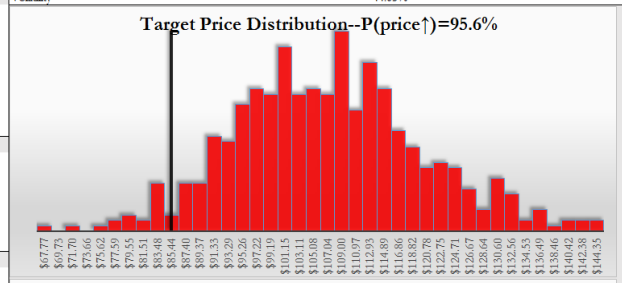
Quarter ending	Revenue	EBITDA
12/28/2014	-0.30%	1.32%
3/31/2015	N/A	N/A
7/5/2015	5.17%	19.63%
10/4/2015	4.18%	5.78%
12/31/2015	2.32%	-58.51%
Mean	2.84%	-7.94%
Standard error	1.2%	17.3%

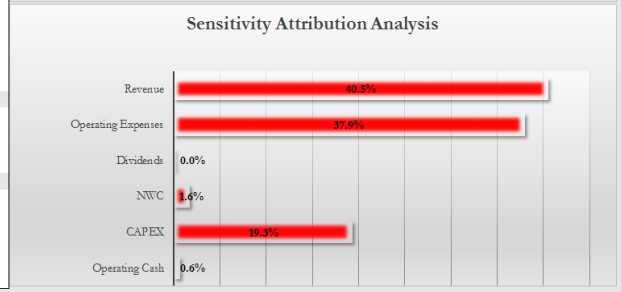
Peers

Triumph Group, Inc.
Rockwell Collins Inc.
B/E Aerospace Inc.
TransDigm Group Incorporated
Spirit AeroSystems Holdings, Inc.
Esterline Technologies Corp.
Raytheon Company
Curtiss-Wright Corporation

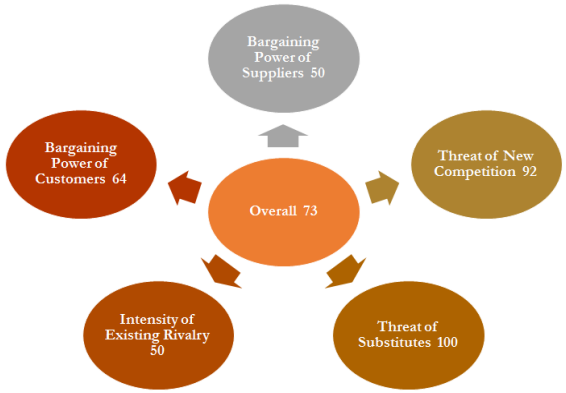
Management	Position	Total compensations growth	Total return to shareholders
Thompson, David	Co-Founder, Chief Executive	N/M	17.94% per annum over 1y
Webster, Scott	Co-Founder, Independent Dire	N/M	17.94% per annum over 1y
Pierce, Garrett	Chief Financial Officer	N/M	17.94% per annum over 1y
Larson, Blake	Chief Operating Officer	-1.46% per annum over 6y	N/M
Wolf, Christine	Senior Vice President of Hum	N/M	17.94% per annum over 1y
Kahn, Michael	Executive Vice President and	2.11% per annum over 4y	N/M

Profitability	OA (LTM)	OA (5 years historical average)	Industry (LTM)
ROIC	8.3%	17.17%	15.27%
NOPAT Margin	9%	17.41%	8.4%
Revenue/Invested Capital	0.92	0.99	1.83
ROE	9.8%	9.81%	17.90%
Adjusted net margin	8%	15.73%	7.8%
Revenue/Adjusted Book Value	1.27	0.62	2.30
Invested Funds	**OA (LTM)**	**OA (5 years historical average)**	**Industry (LTM)**
Total Cash/Total Capital	2.0%	6.4%	20%
Estimated Operating Cash/Total Capital	2.0%	4.9%	N/A
Non-cash working Capital/Total Capital	23.1%	23.5%	13%
Invested Capital/Total Capital	100.2%	98.8%	79%
Capital Structure	**OA (LTM)**	**OA (5 years historical average)**	**Industry (LTM)**
Total Debt/Common Equity (LTM)	0.30	0.34	0.21
Cost of Existing Debt	5.81%	6.13%	4.18%
Estimated Cost of new Borrowing	2.40%	2.52%	4.18%
CGFS Risk Rating	AA	AA	A
Unlevered Beta (LTM)	0.94		0.86
WACC	9.00%	9.00%	8.30%





Porter's 5 forces (scores are out of 100)



Valuation

Period	Revenue growth	NOPAT margin	ROIC/WACC
Base Year	105.6%	9.0%	0.92
12/31/2016	1.9%	14.5%	1.42
12/31/2017	4.9%	14.2%	1.33
12/31/2018	5.2%	13.8%	1.29
12/31/2019	3.5%	12.8%	1.18
12/31/2020	3.4%	12.1%	1.11
12/31/2021	3.4%	12.4%	1.14
12/31/2022	3.3%	12.5%	1.15
12/31/2023	3.2%	12.5%	1.14
12/31/2024	3.1%	12.4%	1.13
12/31/2025	3.1%	12.3%	1.12
Continuing Period	3.0%	12.2%	1.11

Period	Invested Capital	Net Claims	Price per share
Base Year	$3,341.33	$1,568.80	$84.88
12/31/2016	$3,490.20	$1,053.00	$102.00
12/31/2017	$3,972.34	$342.55	$118.77
12/31/2018	$5,626.02	-$337.67	$135.48
12/31/2019	$4,918.69	-$1,035.39	$152.02
12/31/2020	$5,236.32	-$1,720.42	$168.34
12/31/2021	$5,818.48	-$2,432.81	$185.24
12/31/2022	$6,162.54	-$3,165.53	$202.63
12/31/2023	$6,526.40	-$3,912.18	$220.40
12/31/2024	$6,810.71	-$4,668.22	$238.48
12/31/2025	$7,059.00	-$5,432.82	$256.87
Continuing Period			