



600 PENNSYLVANIA AVE SE
SUITE 220
WASHINGTON DC 20003

202.548.0111 p
www.capalphadc.com

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Byron Callan
byron.callan@capalphadc.com
(202) 527-0277

Defense Field Notes: Russian Military Erosion – Something on Which to Noodle

We attended a Jamestown Foundation lunch presentation on “Russia’s Military Transformation; Implications for NATO.” The discussion confirmed what investors probably already know but there were some points worth pondering and possibly some investment angles to pursue. Here’s our summary:

- Russia’s aspirations to have one of the 5 best militaries in the world and 70% of its units equipped with modern equipment by 2020 appear wildly optimistic. Reform and reorganization has been chaotic at best. Corruption remains a real problem. Russia’s military still does not have the analytical tools to assess reform and military leadership has lost confidence in its industry to deliver world-class equipment. This has been evidenced by purchases of Israeli UAVs and a plan to acquire amphibious assault ships from France (Mistral is built in a French state-owned naval yard, but Thales owns a share of this enterprise) – however this deal is being held up over technology transfer negotiations.
- While Russia’s main military focus has been NATO, in the past year or two, it has increasingly shifted focus to China’s military modernization effort. This was underscored by a Chinese military exercise in 2008-09 that postulated projecting a military force 2,000 km. These sorts of distances point to the Russian Republic and/or central Asia. Russia responded with its own exercise in 2010 aimed at countering a hypothetical move by China. The Russian military is focused on how China’s military modernization is surpassing Russian capabilities.
- The state of conventional Russian military units in the Far East is very poor and this entails that Russia continues to place heavy emphasis on tactical nuclear weapons. Doctrine calls for initial strikes with tactical nuclear weapons on enemy command and control sites. While tactical nuclear weapons are currently held in central storage facilities, one speaker wondered how stable this would prove to be if Russia faced a crisis. Deployment of Russian ground units is mainly along central Asian and Far East regions, with a central reserve, indicating this shift and it is these units (+40 brigades) that are the focus of future modernization.
- There are some mixed investment implications for defense stocks in 2012-14. For European and U.S. stocks, Russian military developments may have increasingly minimal impact. Russia is losing a core defense client in Libya and the same will probably happen with Syria. Its industry is increasingly less and less a factor in global defense markets. However, it might be worth a look at the Israeli defense sector as one speaker noted a growing interest in Russia in network-centric warfare. There is at least one public Israeli defense stock, though clearly a meaningful Russian market could take another 1-2 years to develop.

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