Many Forces Putting Pressure on Munitions Budget

Our challenge is to keep pressures from affecting readiness and national security.

Defense Budget
"Cut $150B Over 5 Years"

Troop Reductions

Munitions Budget

Increased Health Care Costs for All Services

War Reserves are Healthy

US Deficit & Need to Reduce Spending

Photo Courtesy U.S. Army
US DoD Budget Authorization ($ billions)

- **Base Budget CAGR 2002-2010 ~ 6%**
- **Total Budget CAGR 2002-2010 ~ 9%**
- **OCO Funding 2012-2015 ???**
- **Base Budget Estimated CAGR 2011-2015 ~ 1%**

- Secretary Gates remarks on January 6th: base DoD budget will be roughly flat beyond FY12
- OCO spending beyond FY11 remains uncertain – total DoD budget authority likely to decline
- Uncertain whether Congress will force additional cuts to DoD budgets

Source: DoD budget data and estimates based on Sec. Gates press conference on Jan 6, 2011
Defense Spending Historically Moves in Long Cycles

Historical Growth in US Defense Investment Accounts (Procurement + RDT&E)

-20% -10% 0% 10% 20% 30%


10 Years of Growth

11 Years Flat / Declining

12 Years of Growth

???
Stock Prices React Quickly to Lower Defense Budgets

Defense Sector Forward P/E vs. DoD Investment Account Growth

Lower valuations reduce ability to invest

Source: RBC Capital Markets research report, January 10, 2011
Industry has Reacted to Lower Defense Budget

• Multi-industry firms may look to exit the defense business (ITT)
• Defense primes looking to divest non-core or slower growth assets (Northrop)
• Increased focus on cost management
  ➢ Down-sizing workforce
  ➢ Facility consolidation
• More focus on minimizing risks – (Northrop decision to “no-bid” tanker competition)
• Shifting capital deployment priorities – increasing focus on dividends and share buybacks vs. investments in growth
• Reshaping company portfolios to balance defense content
• International market pursuits to fill holes in domestic revenue

Prolonged downturn in defense spending likely leads to more adjustments
New Directives from DoD Add Uncertainty to Contracting Environment

Ashton B. Carter Memo – November 2010

- Target Affordability and Controlling Cost Growth
- Incentivize Productivity and Innovation in Industry
- Promote Real Competition
- Improve Tradecraft in Services Acquisition
- Reduce Non-productive Processes and Bureaucracy

Reaction to a shrinking budget and contract initiatives will determine the impact to munitions base
Munitions Community Has Strong Performance History

- PEOs have considered the industrial base in their acquisition strategies
  - IBAT/MSR is an important tool
  - All companies should engage
- ICAP, MIBTF, and MES provide forums for open dialogue and collaboration
  - Soft Landing initiatives
- Munitions industry is relatively lean
- Government has used appropriate contract types
- Good participation by small businesses
- Open dialogue with PMs on upcoming funding and strategies to manage through difficult times

We must continue our cooperation
Five Recommendations for the Path Forward

1. Make proactive decisions driven by leadership engagement
2. Practice open and early communication
3. Continue collaboration between government/industry and between companies
4. Be willing and able to manage change
5. Lean out our processes and operations
• Some contracting initiatives intuitively conflict

Government desire for increased industry R&D investment

Reduced budgets, government ownership of tech data, and lifetime competition

• Potential solutions will require collaboration
  • Significant production quantities prior to competition
  • Leader/follower strategy with fee/work share rewards for investment and tech data
  • Accept competition at sub-tier supply levels
  • Preferred Supplier Programs (e.g. Navy SSIP)
Opportunities are plentiful

- Procurement timelines need significant improvement
- Export licensing approval process
- Review and approval cycles for configuration control
- Logistics and movement of product throughout the value chain

Current State

Most administrative processes have opportunities for 50% to 75% reductions in work flow and cycle times

Future State

“Every problem has a gift for you in its hands.”
Richard Bach
Open and Early Communication

- Build realistic “Should Cost” targets with involvement of industry
- Discuss potential risks as production quantities decrease to allow industry to adjust investments and work force levels
- Engage in discussions to develop strategies to split procurements
- Supplement use of IBAT/MSR with discussions as budgets are created
- Set realistic production quantities in initial program RFPs
- Industry has responsibility to notify customers early if significant supply chain and factory changes likely to occur
We Must be Willing to Manage Change

• Evaluate whether dual sources are affordable at reduced quantities and could drive participants out of the base

• Share cost or offer incentives to redesign processes and equipment for flexibility

• Update designs for current industry accepted test methods and specifications

• Rationalize munitions portfolio to reduce need to maintain unique capabilities

• Creative contract clauses to deal with uncertainty of production quantities
  
  • Recovery of investment
  
  • Flexible delivery schedules

• Best value or best price?
Leadership Engagement and Proactive Decisions

Team empowerment and leadership engagement is critical.

Proactively and collectively shape our future.

Maintain a healthy industrial base.

Munitions base readiness ensures Warfighter readiness.