



# ***Lockheed Martin and Industry Issues***

***Army Contracting Symposium  
July 12, 2006***

***Eleanor Spector  
Vice President  
Contracts***

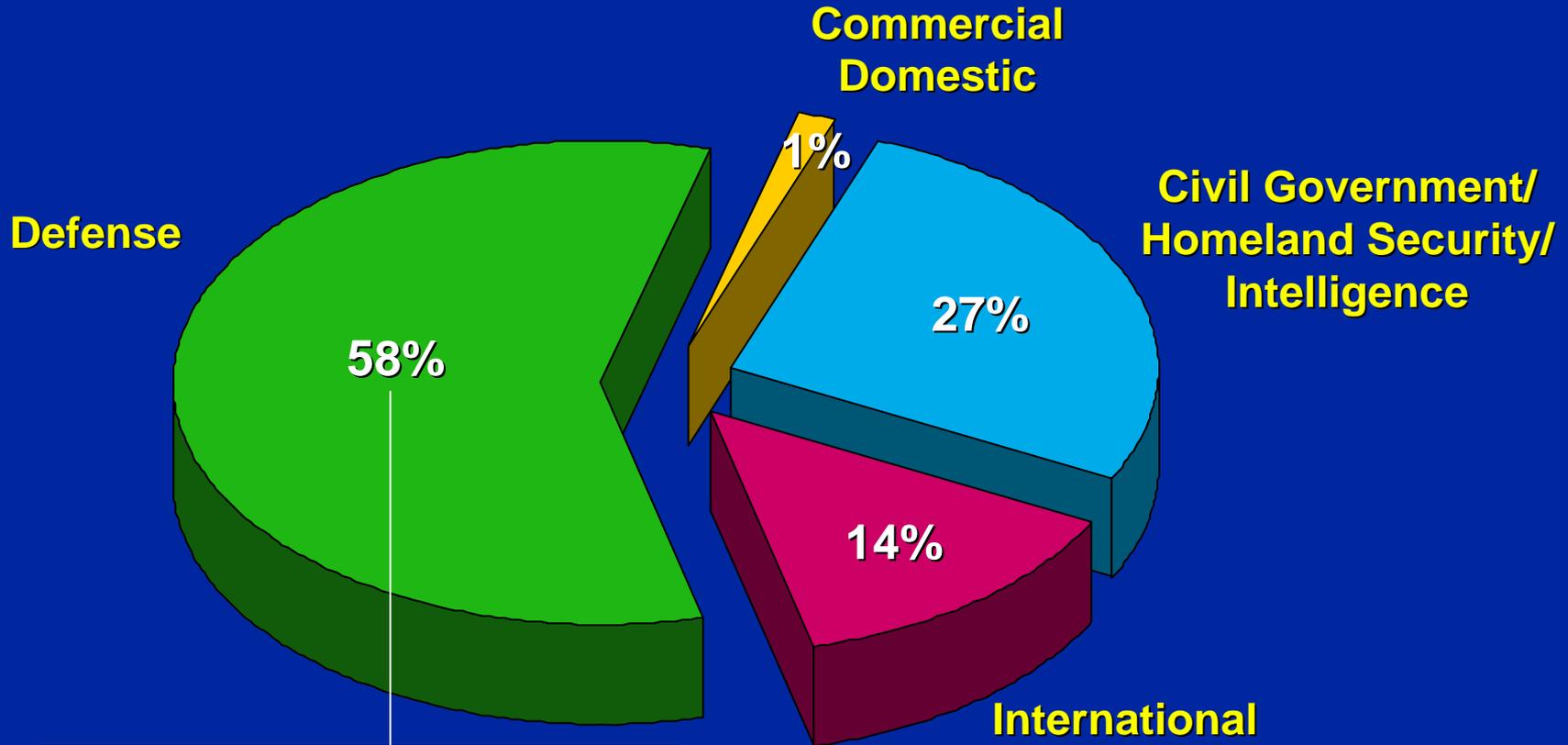
# The Men and Women of Lockheed Martin



- 135,000 Employees
- 60,000 Scientists and Engineers
  - 20,000 IT Professionals
- Operations in 1,000 Facilities, 500 Cities, 45 States and 56 Countries

Partners to Help Customers Meet Their Defining Moments

# 2005 Sales by Customer



**Total Sales - \$37.2B**

# Major LM Army Programs



- **Patriot Advanced Capability 3 (PAC 3)**
- **Medium Extended Air Defense System (MEADS)**
- **Terminal High Altitude Air Defense (THAAD)**
- **Guided Multiple Launch Rocket System**
- **Javelin Antitank System**
- **Modernized Target Acquisition Designation Sensor (MTADS)**
- **Army Knowledge Online (AKO)**
- **WIN-T**
- **Information Technology Enterprise System (ITES)**
- **Warfighter Simulation (WARSIM)**
- **Virtual Convoy Tactical Trainer (VCTT)**
- **Future Tactical Truck**



# ***Industry Economics***

# Stakeholder Expectations



- **Customers**
  - Programs on time, on budget, with operational excellence, innovation
- **Employees**
  - “Employer of Choice”
- **Debt holders**
  - Repayment of debt with interest
- **Shareholders**
  - Return on Investment

**Must Balance Interests**

# Shareholder Expectations



- **Program performance and customer satisfaction**
- **Strong management team**
- **Recruitment and retention of the best people**
- **Ethical culture and corporate governance**
- **Consistent cash flow generation**
  - **Dividends**
  - **Debt reduction**
  - **Share repurchase**
  - **Acquisitions**
  - **Internal investment**
- **Improving sales, backlog, and profit margins**

**Profit is Vital to the Survival of the Corporation**

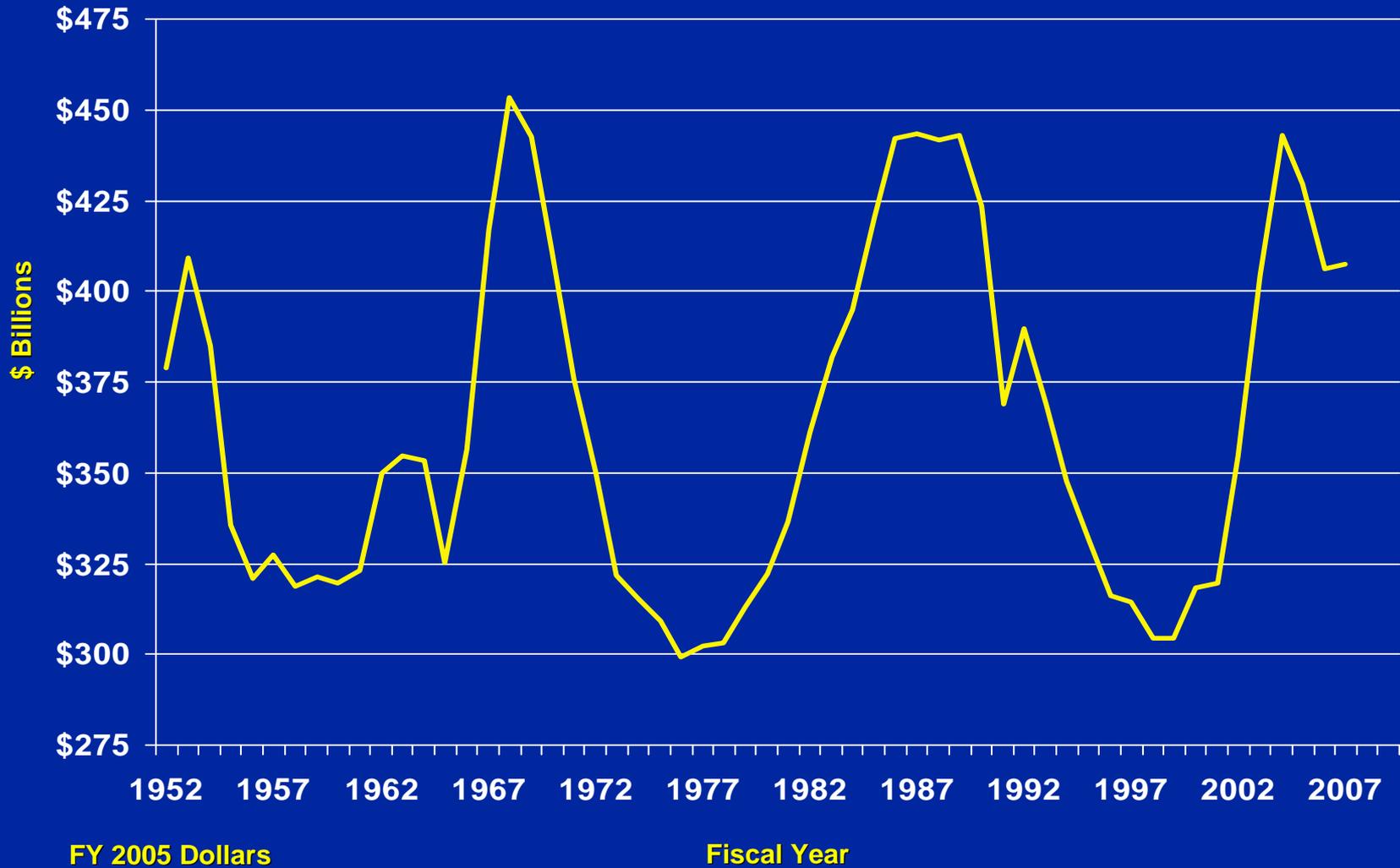


# Business Risk in Our Market

- Monopsony
- Program and Funding Instability
- Single Year Procurements
- Investment Requirements versus Recovery with Adequate Returns
- Program Performance



# Defense Outlays



# Competitive Development



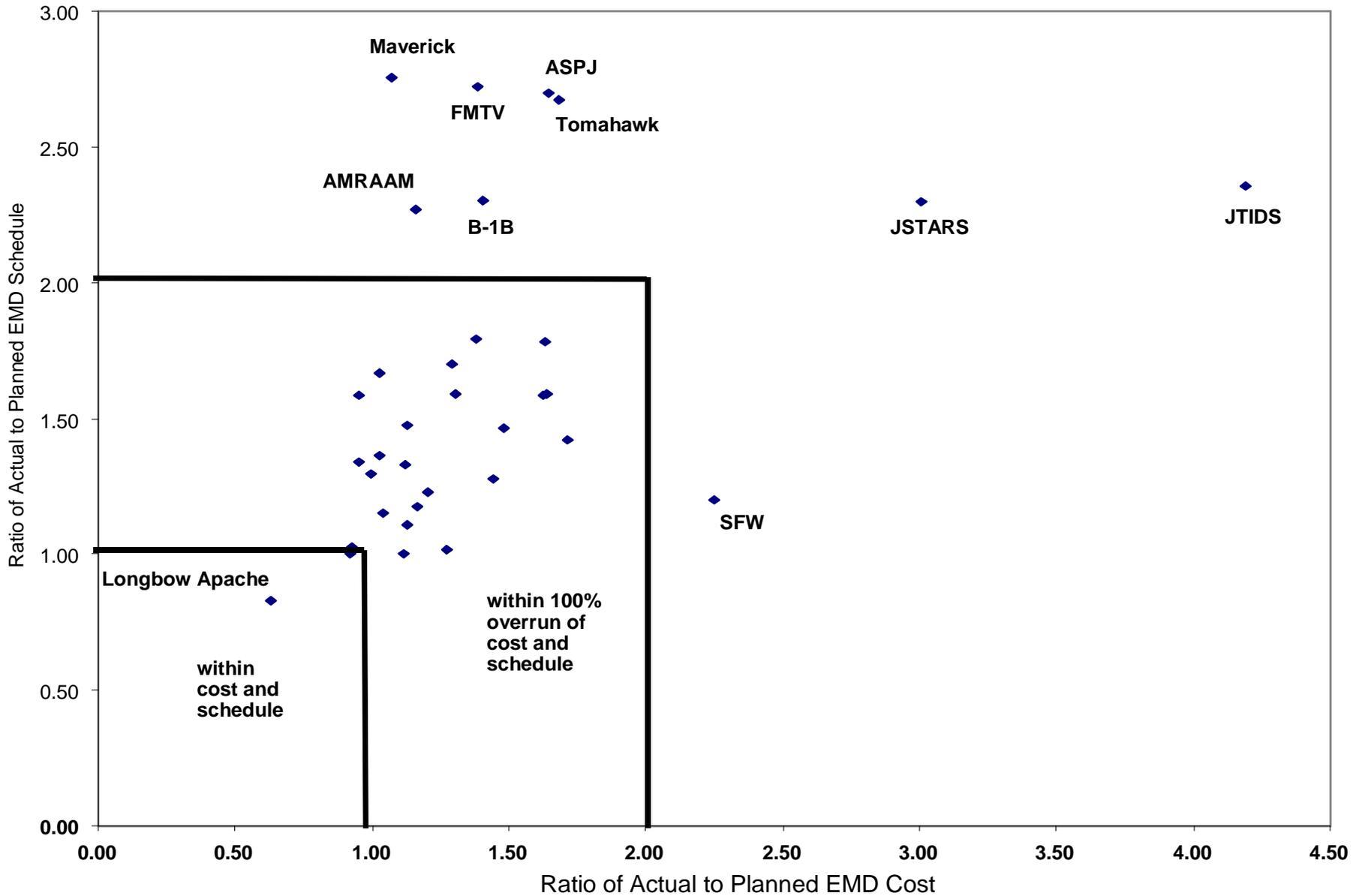
- **The lowest margins are on development programs where there is the greatest investment in facilities and equipment, and the need for the most highly skilled work force.**
- **Development is ~48% of DoD's procurement and R&D outlays.**
- **The Defense industry can no longer rely on production programs which produce higher margins.**
- **Lower margins in development, the high percentage of development programs, and the uncertainty of production, results in an uncertain outlook for Defense industry profitability.**



# Root Causes of Overruns

- **Lack of technology maturity...unknown/unknown technical challenges**
- **Uncontrolled requirements growth**
- **Program funding perturbations**
- **Unrealistic cost estimates**
  - **Optimistic budget estimates**
  - **Impact of competition on “price to win”**
- **No contingency funding in budgets or proposals**

Ratio of Actual to Planned EMD Cost and Schedule





# Desired Government Actions

- Use the appropriate type of contract
- Provide base fee routinely
- Provide provisional billing of award fee routinely
- Increase base and available award fees
- Permit fee rollover
- Use subjective criteria for award fees
- Prohibit profit takeback penalties
- Prohibit fixed priced options before major system design

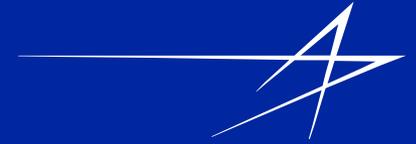
**Within DoD Control**

# Desired Government Actions



- **Do not encourage or require contractors to supplement appropriations for R&D by:**
  - **Using IR&D to subsidize contract R&D**
  - **Establishing cost ceilings that in essence convert cost-type contracts into fixed-price contracts**
  - **Capping annual funding increments unreasonably on R&D contracts**
  - **Awarding contracts at prices that are known to be less than the probable cost of performance**

# Economics Summary



- **Financially sound contractors are able to attract the resources and talent necessary to provide best value solutions to warfighters and taxpayers.**
- **Profit is vital to the survival of any industry including the defense industry.**
- **Contractors must be given the opportunity to earn fair profits.**



# ***FY 2007 Defense Authorization Bill***

# Berry Amendment



- **Since 1972, DoD aircraft, missile, ship, tank/automotive, weapon, and ammunition purchases must incorporate specialty metals reprocessed or produced in the U.S.**
- **280+ suppliers of low value, dual use commercial parts (e.g, screws, springs, nuts, filters, washers, bolts) do not comply or are unable to verify compliance.**
- **Deliveries from suppliers have been impacted on programs including PAC - 3 and MLRS.**
- **Lockheed Martin seeking DNAD waiver on integrated circuits and semiconductors from the Army and the Air Force.**

***Impossibility of Performance in Supply Chain***

# Senate Warner Amendment



- **Exception to Berry Amendment for commercial items at any tier of the supply chain. “Commercial item” does not include an item that contains more than 5% non-commercial modifications.**
- **Provides *de minimis* exception allowing DoD acceptance of an item containing non-preferred specialty metals not exceeding 2% of the total amount of specialty metals in the item.**
- **Permits use of non-preferred specialty metals if the contractor acquires an equivalent amount of domestic specialty metals.**

***Industry Strongly Supports***

# Fixed Price Development

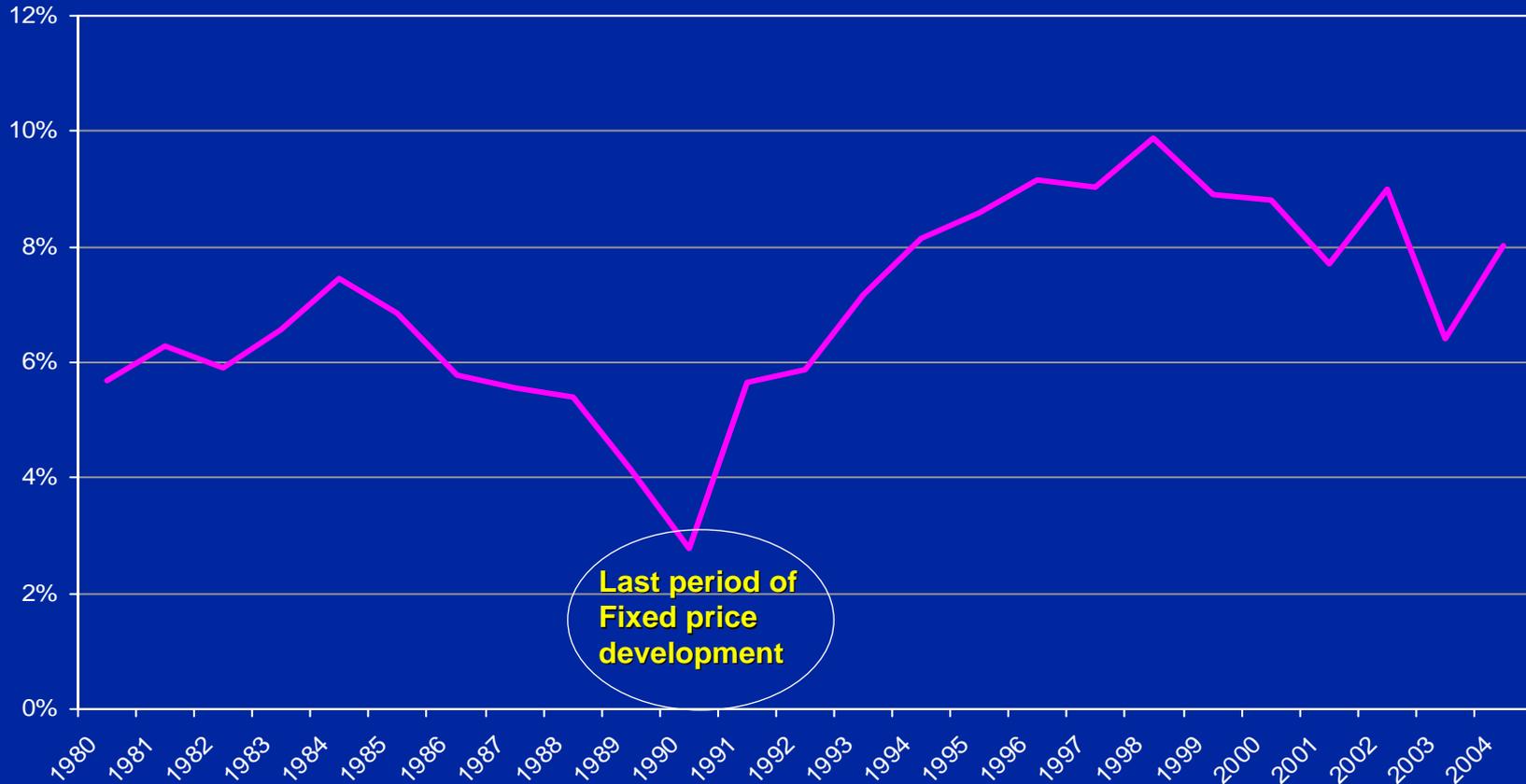


- **Preference for FP contracts for development, with waivers at the SECDEF level. Inappropriate use of FP contracts for development has never resulted in a successful program. The Statement of Administration Position opposes this section.**
- **There is hard evidence several fixed price development programs caused industry profits to decline substantially and resulted in the near bankruptcy of companies who had those contracts.**

# Defense Industry Margins



CSIS Defense Index Average Operating Margin (weighted by revenue)



Note: CSIS Defense Index comprises 36 publicly-traded companies with majority revenues derived from US defense business. Boeing Military results have also been included.

Sources: FactSet, Company Reports, CSIS Analysis.



# ***Service Contract Manpower Reporting***

# January 2005 SecArmy Memo



**Imposes burdensome reporting requirements to ensure that “contractor support” figures are included in Army manpower reports.**

- Level of detail inconsistent with law that limits data to that available from contractor’s existing systems. Other Military Departments use existing information.**
- Applied beyond traditional services contracts (R&D, SDD, production), not just for contractor manpower typically performed by Army internal resources.**

# Industry Position



- **Necessary information for compliance with statutory reporting requirement is available without this report.**
- **Should not be applied to design, manufacture or support of hardware deliveries.**
- **In December 2005, Aerospace Industries Association requested Army eliminate the reporting requirement. Notwithstanding follow-up requests, still awaiting response from ASA(M&RA).**

# Summary



- **Your attendance at this conference is a positive indication that you seek to understand the major issues affecting the Government and Industry Contracting community.**
- **Reaching agreement on issues is easier when Government and Industry are well informed.**

