

**Innovation ... Delivered.**

**Munitions Industry Readiness**

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# Many Forces Putting Pressure on Munitions Budget

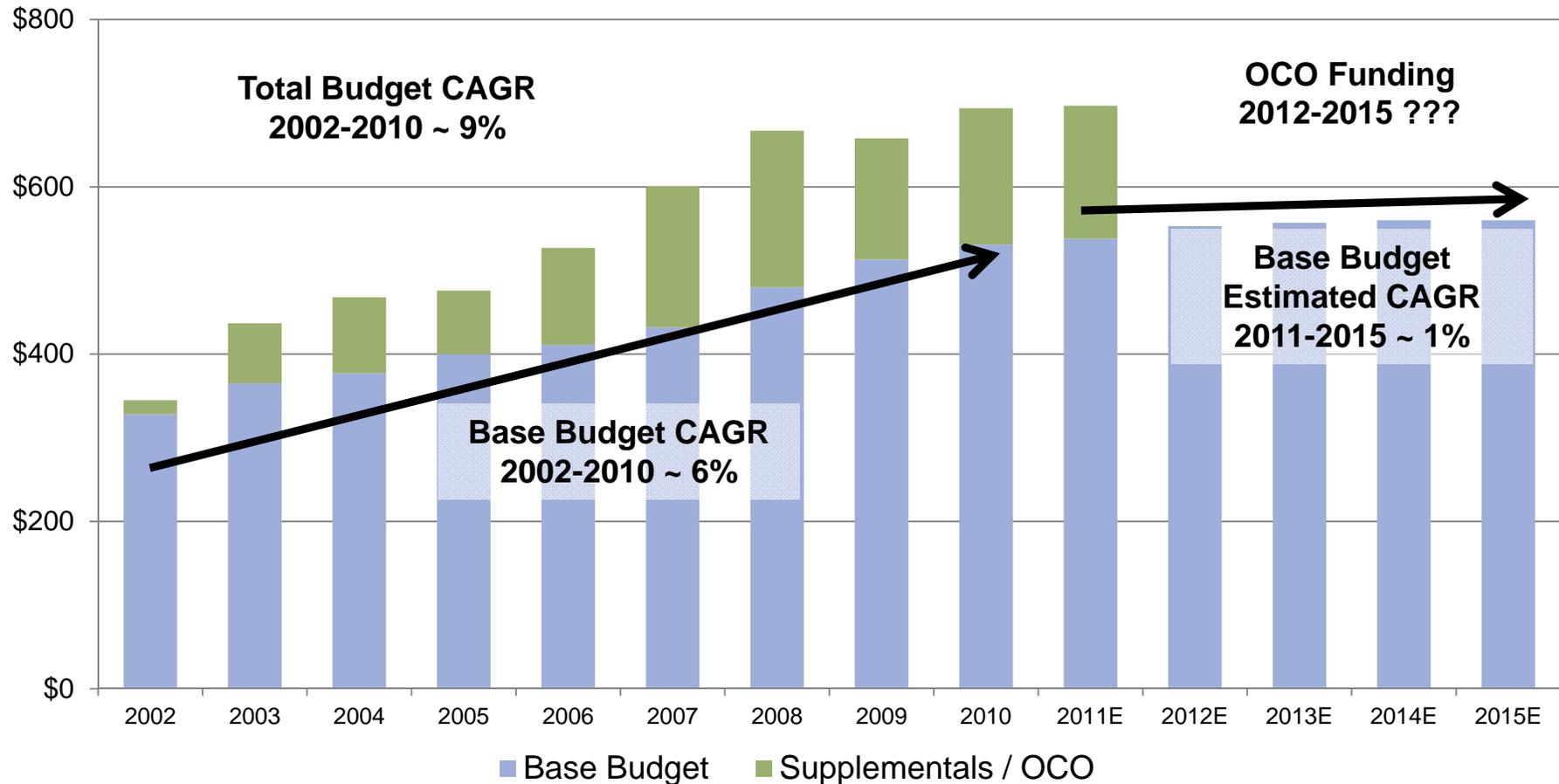


**Our challenge is to keep pressures from affecting readiness and national security**

# US Defense Spending is Poised for a Slowdown



## US DoD Budget Authorization (\$ billions)

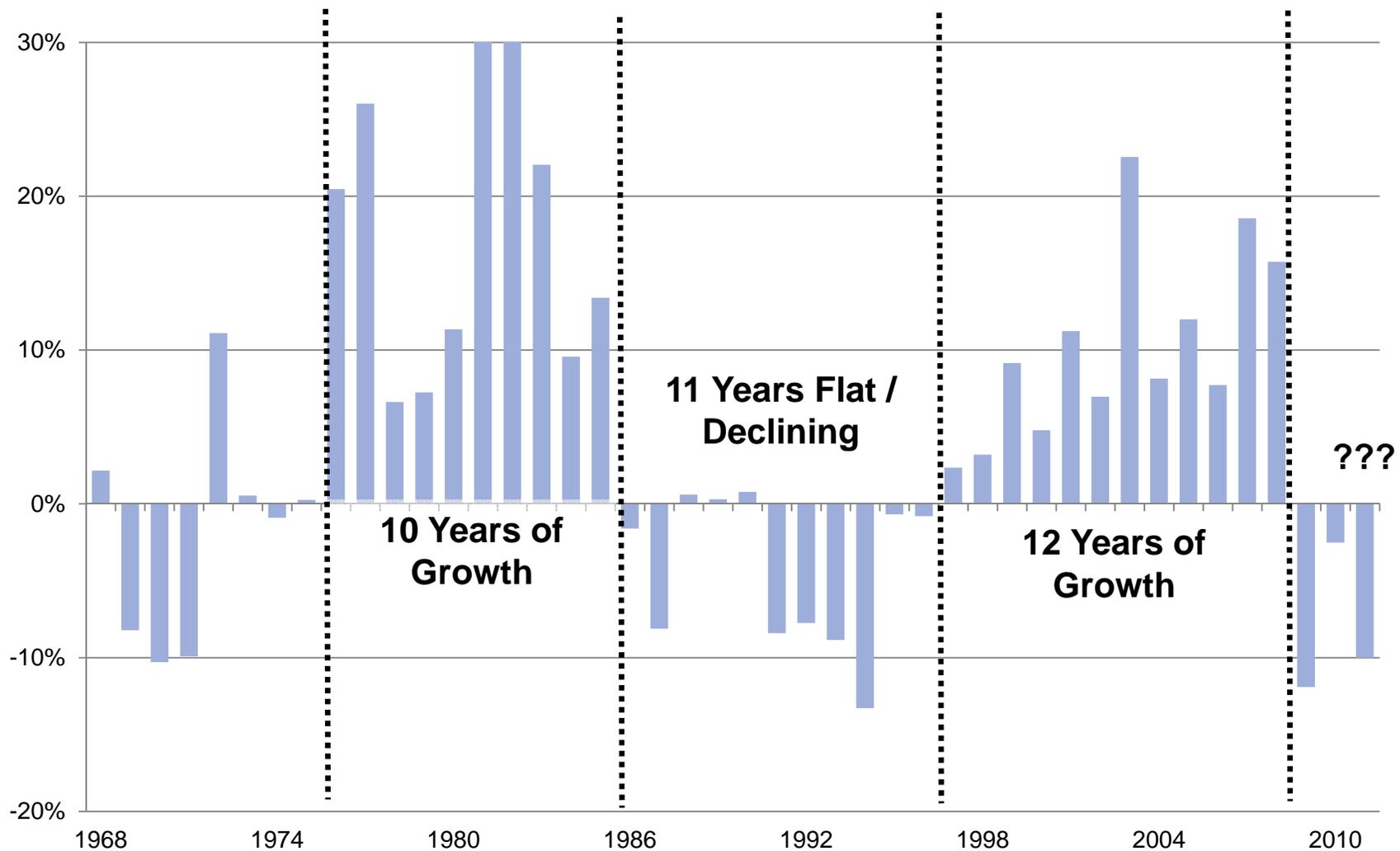


- Secretary Gates remarks on January 6<sup>th</sup>: base DoD budget will be roughly flat beyond FY12
- OCO spending beyond FY11 remains uncertain – total DoD budget authority likely to decline
- Uncertain whether Congress will force additional cuts to DoD budgets

# Defense Spending Historically Moves in Long Cycles



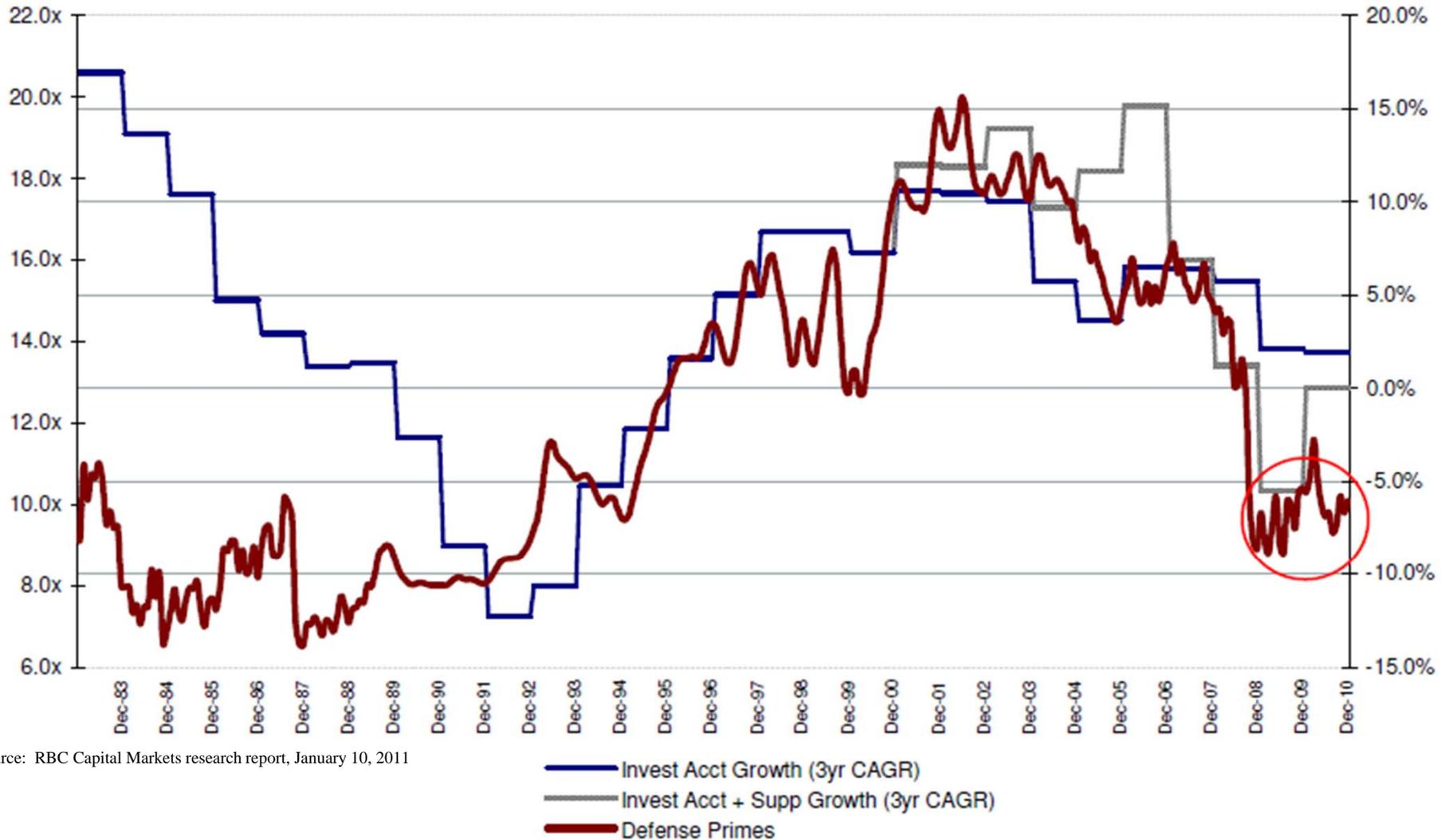
## Historical Growth in US Defense Investment Accounts (Procurement + RDT&E)



# Stock Prices React Quickly to Lower Defense Budgets



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



Source: RBC Capital Markets research report, January 10, 2011

**Lower valuations reduce ability to invest**

# Industry has Reacted to Lower Defense Budget

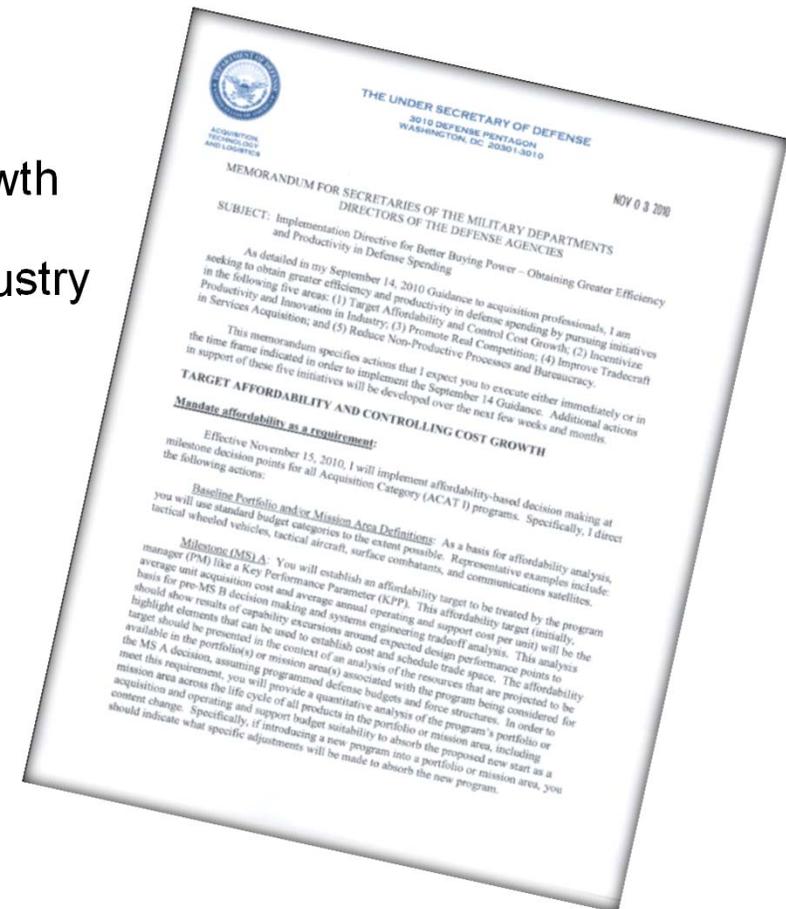


- Multi-industry firms may look to exit the defense business (ITT)
- Defense primes looking to divest non-core or slower growth assets (Northrop)
- Increased focus on cost management
  - Down-sizing workforce
  - Facility consolidation
- More focus on minimizing risks – (Northrop decision to “no-bid” 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**

## 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

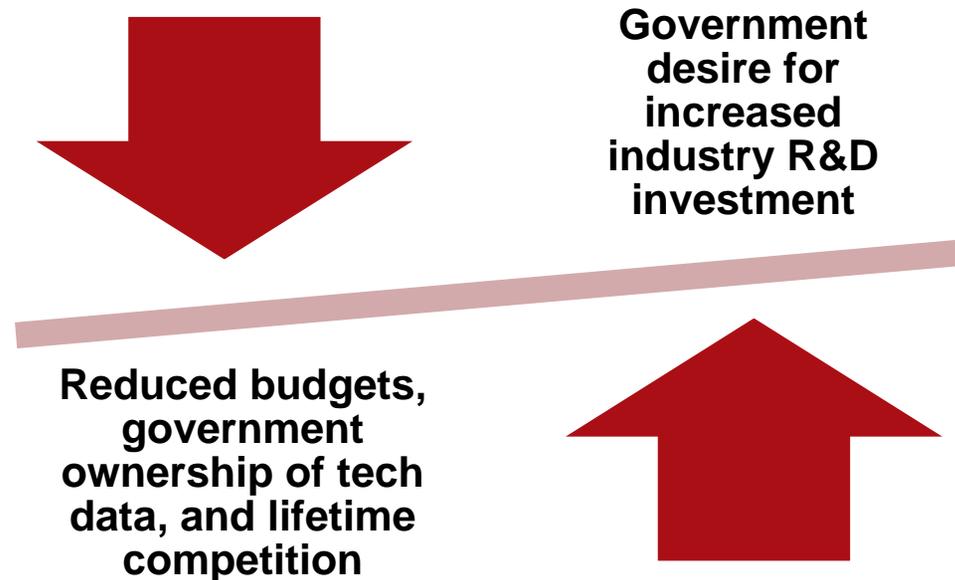


**We must continue our cooperation**

# Five Recommendations for the Path Forward



- Some contracting initiatives intuitively conflict



- 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

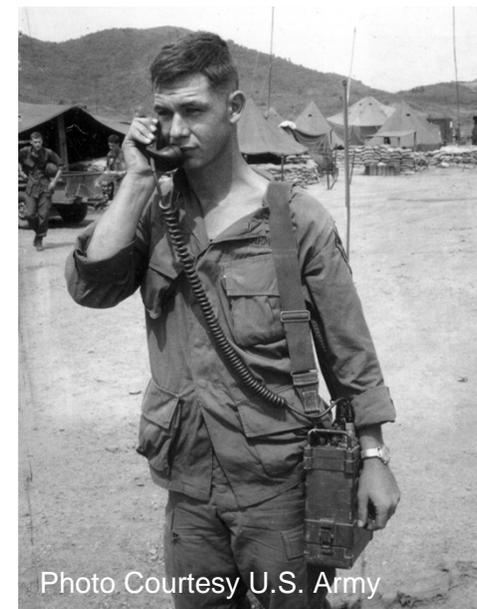
***“Every problem has a gift for you in its hands.”***

Richard Bach

# Open and Early Communication



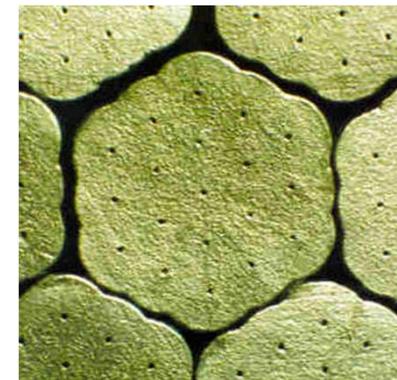
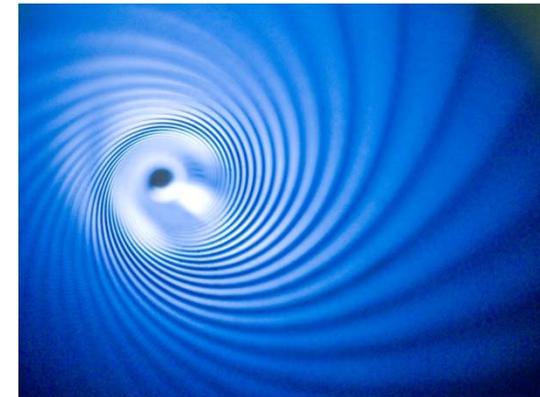
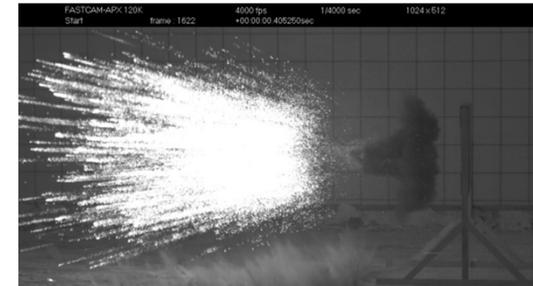
- Build realistic “Should Cost” targets with involvement of industry
- Discuss potential risks as production quantities decrease to allow industry to adjust investments and work force levels
- Engage in discussions to develop strategies to split procurements
- Supplement use of IBAT/MSR with discussions 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

