
Why Should A Contractor Want to Participate in PBL?

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A Financial Overview of Defense Weapon System Contractors

Organizations with the majority of revenues from DoD contracts	Profit Before Taxes (PBT) As A % Of Sales				2004 Sales	1/1/05 Stock Value
	2001	2002	2003	2004		
General Dynamics	11%	10%	9%	8%	\$19B	\$22B
Boeing	7%	1%	6%	8%	\$52B	\$43B
Northrop-Grumman	4%	0%	4%	5%	\$29B	\$13B
Lockheed Martin	0%	3%	4%	5%	\$35B	\$16B
Raytheon	0%	7%	4%	3%	\$20B	\$10B
Others						
GE	15%	15%	15%	15%	\$141B	\$365B
United Technologies	10%	11%	11%	12%	\$36B	\$50B
Budweiser	17%	18%	19%	20%	\$15B	\$34B

As a result of the West Asia conflict, DoD contractors have materially increased in value, but they could easily return to the above

It's All About Profits

"Government officials generally don't see profit the way it's looked at in the commercial world. The average person working in a program office doesn't see it. While the policy is structured to pay a reasonable profit, the perception in government circles is that contractors are making far more than what they are."

Jack Cash, Business Professor at the Defense Acquisition University, in National Defense 4/05

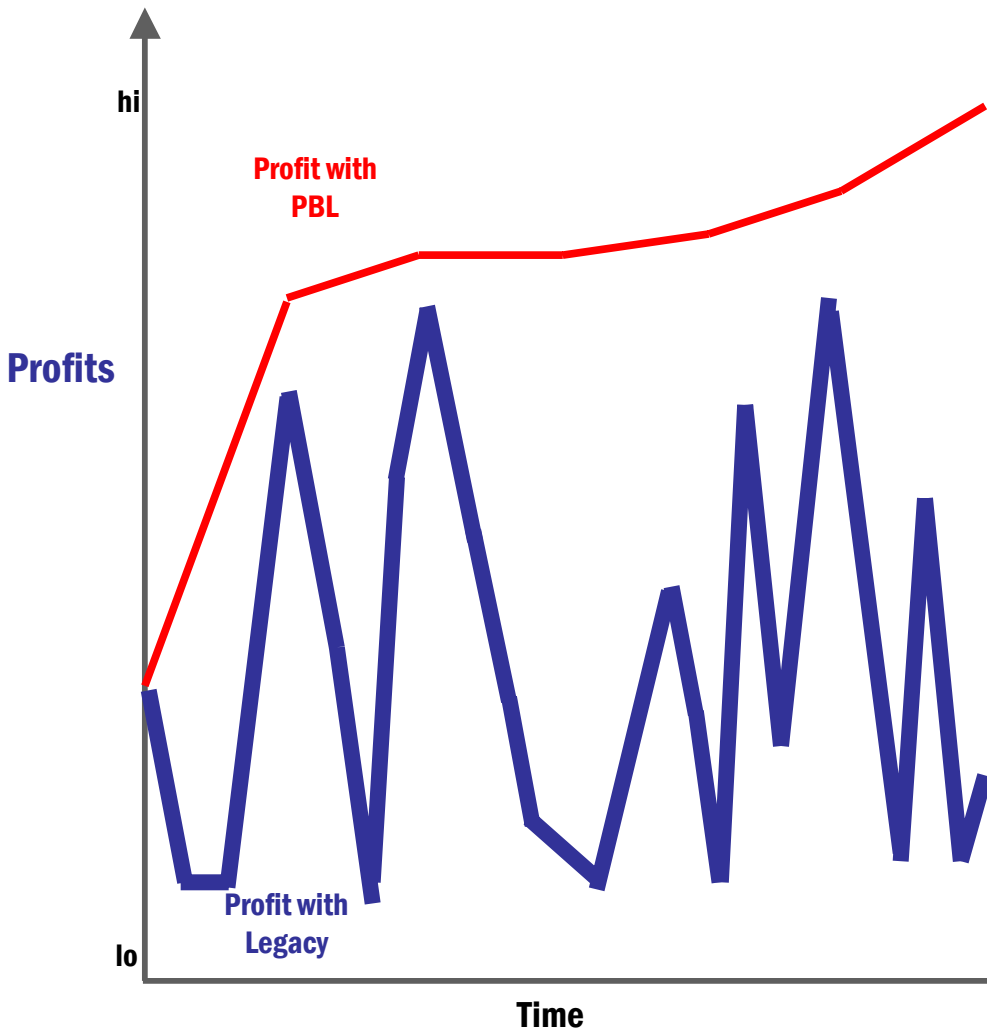
"There are three kinds of expenditures—the cost of capital, the risk premium of economic activity and the capital needs of the future—and they overlap to a considerable extent. But any company should be expected to cover adequately these expenditures. Otherwise it operates at a genuine, certain and provable loss."
-Peter Drucker

It's All About Profits

One possible coping strategy of the prospect of lower DoD business would be to shift from manufacturing to operations and maintenance work, which currently is 65% of the Pentagon's budget and includes everything from payroll to equipment repairs. Equipment used in Iraq has suffered so much wear and tear that it requires major reconditioning. The global war on terror has stressed our assets in the field and spare-part activity will be robust. This is a higher-margin business for defense firms."

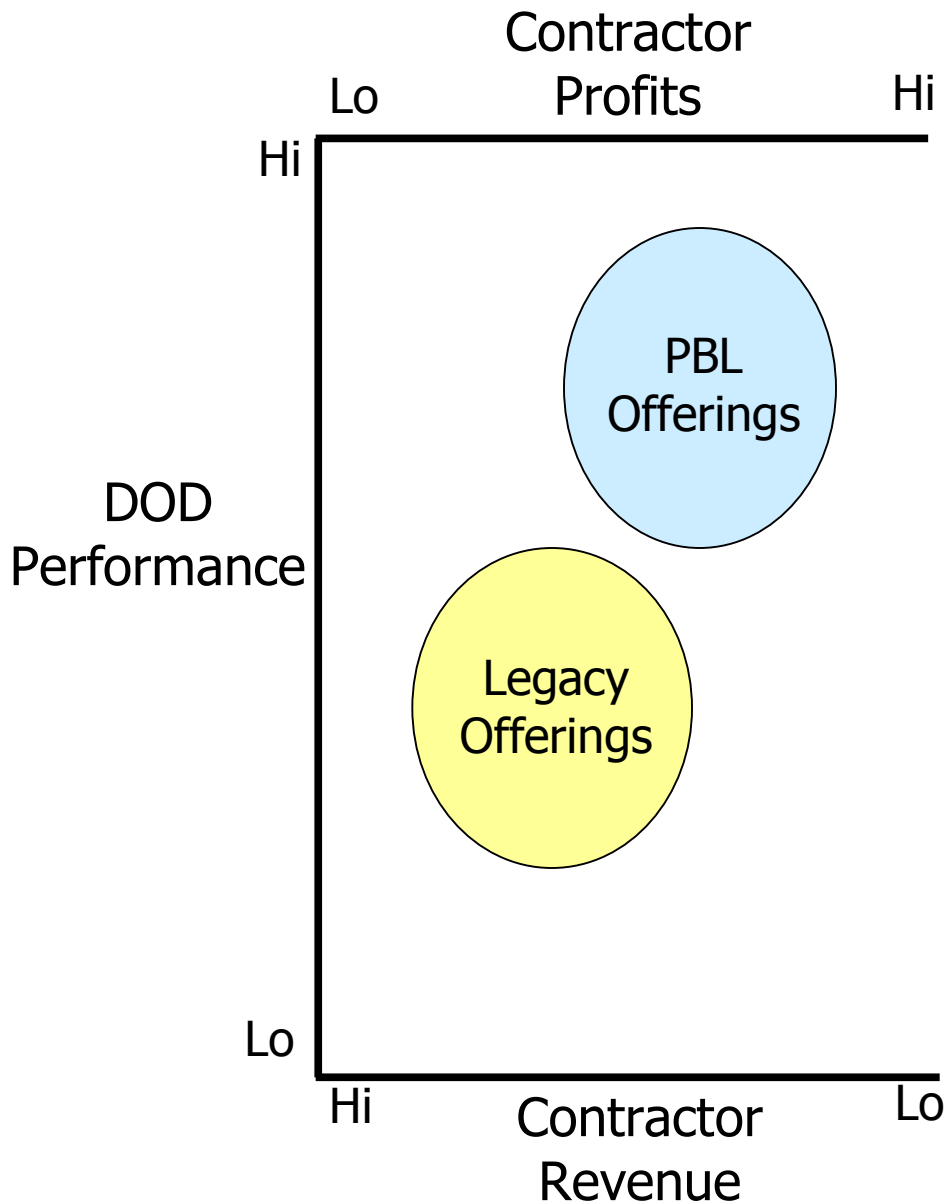
Peter Arment, an analyst at JSA Research, in Barron's 7-18-05

PBL Increases Profits & Reduces Profit Volatility



**Enterprise Value Of Contractors Will Increase;
It's All About Profits, Their Growth And Their Predictability....And Not About Revenue Growth**

The PBL Paradox (P^2)



The 5 Ways Of Increasing Profits

Revenues			Costs			Profits		
Current	New		Current	New		Current	New	
\$1,000	↑	\$1,100	\$950	↑	\$1,000	\$50	↑	\$100
	↑	\$1,025		↓	\$925			\$100
	↑	\$1,050		↔	\$950			\$100
	↔	\$1,000		↓	\$900			\$100
	↓	\$850		↓	\$600			\$250

PBL

The PBL Paradox is difficult for executives to overcome

With Higher Rewards Come Higher Risks

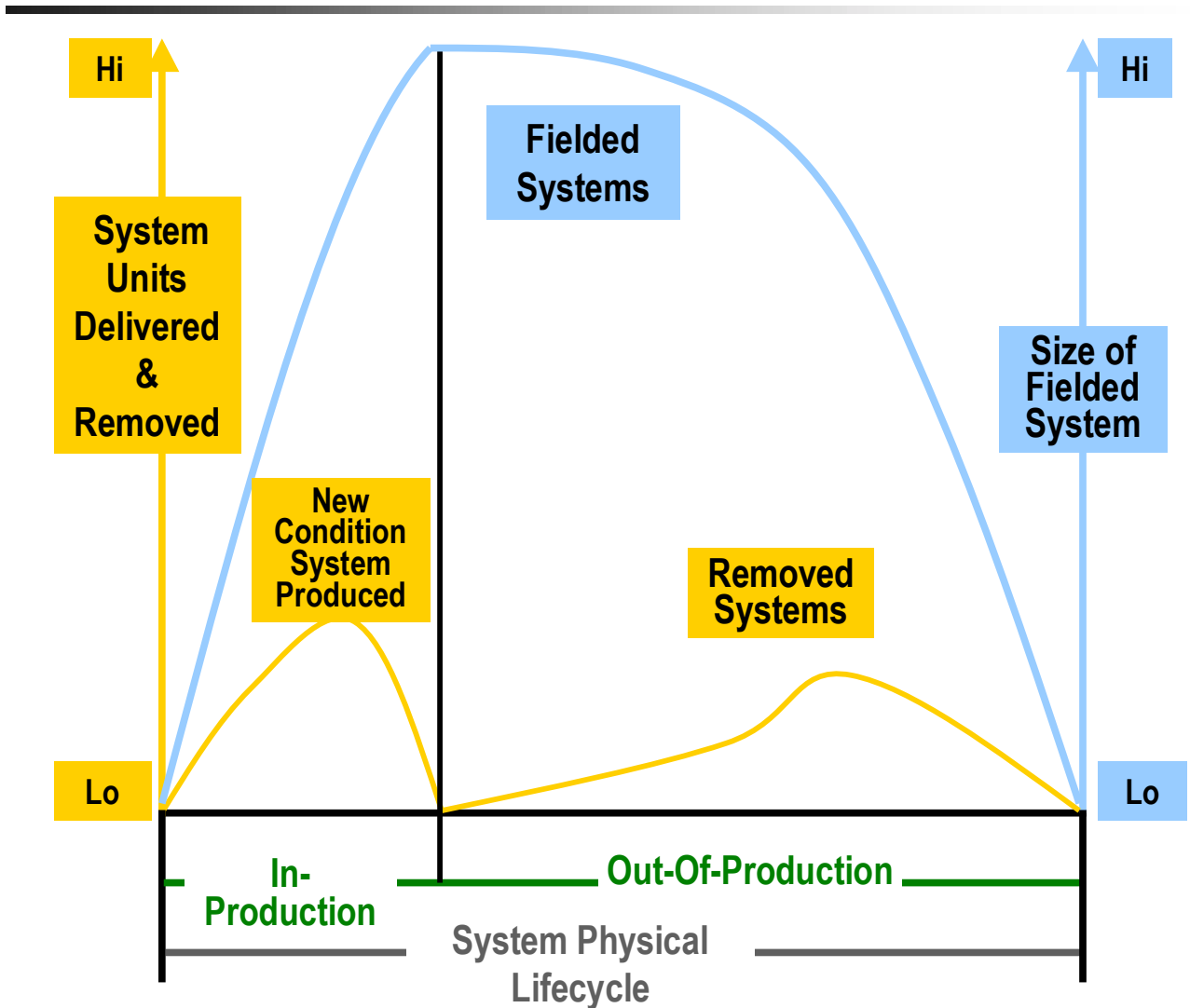
- With PBL there is a higher probability of actual profits being less than planned
- Contractor must manage a “portfolio” of programs and have more “winners” than “losers”
- Planned profits can go “south,” without recourse of relief from DoD, driven by:
 - Unfavorable performance to customer resulting in “penalties” (i.e. availability performance is actually 89% vs 92% assured)
 - Unfavorable internal process management efficiency due to the complexity of delivering offerings (i.e. under-priced offering; forgot “gotchas”)
 - Impairment of contractor-owned assets due to customer terminating program as a result of poor contractor performance or budget cutbacks (i.e. inventory write-off)
 - Higher opportunity costs (i.e. interest rates) of capital due to larger asset investments
 - Others

How Do Contractors Improve DoD Logistics Performance

- Reduce repair/remanufacturing/overhaul process cycle times
- Change piece parts condition requirements for repair process
- Reduce volume performed at depot/ALC
- Disassemble parts from BER unit
- Sell GFE surplus for a brokers fee
- Aggressively negotiate with suppliers for parts costs
- Reduce material asset turnover through advanced planning techniques
-many others

Remember:
Almost every contractor \$\$ expenditure reduced in delivering a service to the DOD flows to the contractor's bottom line

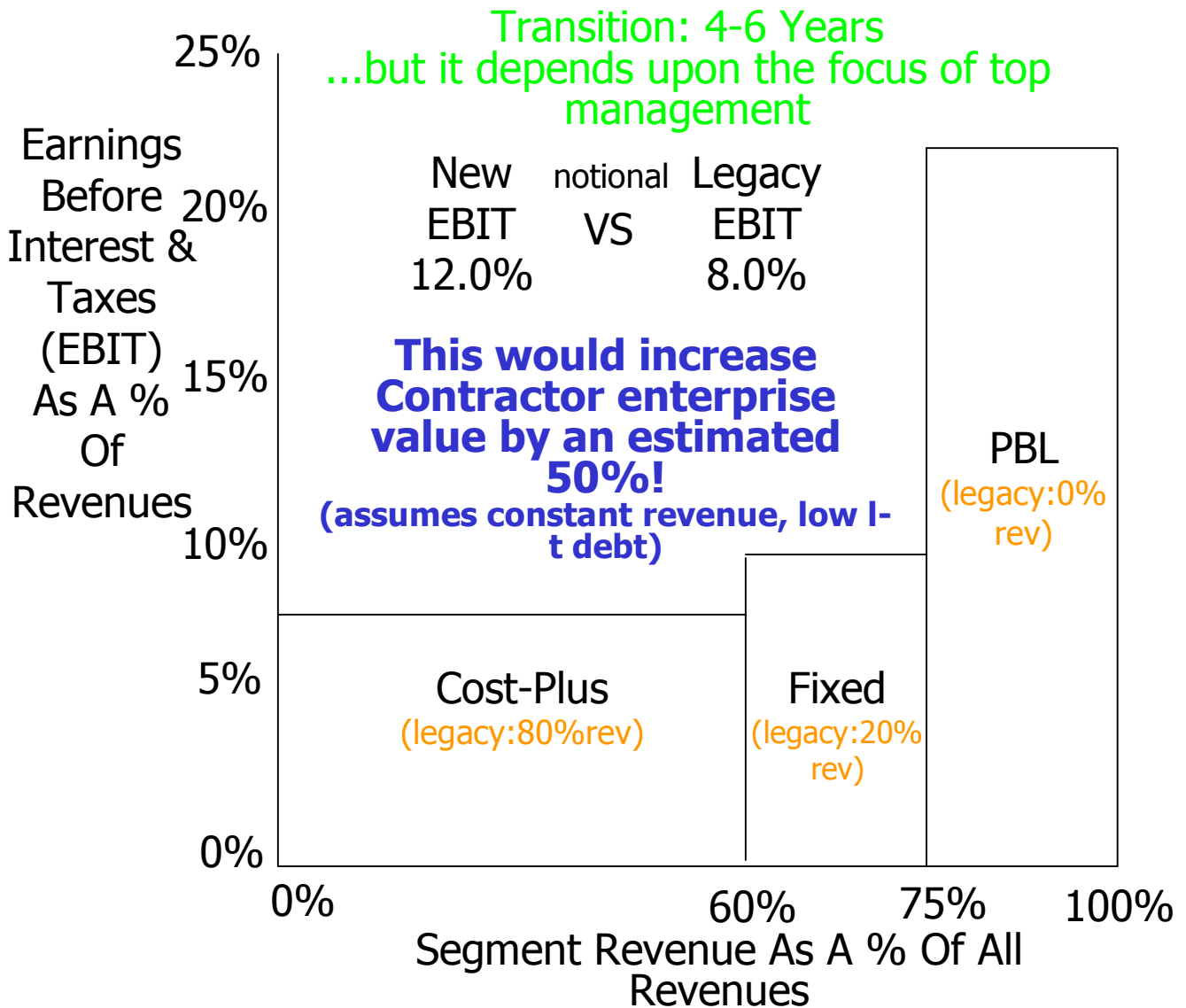
What Is A Contractor's Strategy In Obtaining Revenues From PBL



Defining The Period Of System Lifecycle Coverage Impacts PBL Revenue Opportunities (examples) ...outside of period, contractor offers cost-plus/fixed price CLS

From start of production to end-of-production	5 yrs after start-of-production to when fielded units comprise less than 50 in US inventory
2 yrs after start-of-production to 10 years after end-of-production	3 yrs after start-of-production to when fielded units comprise less than 200 in NATO & US inventory

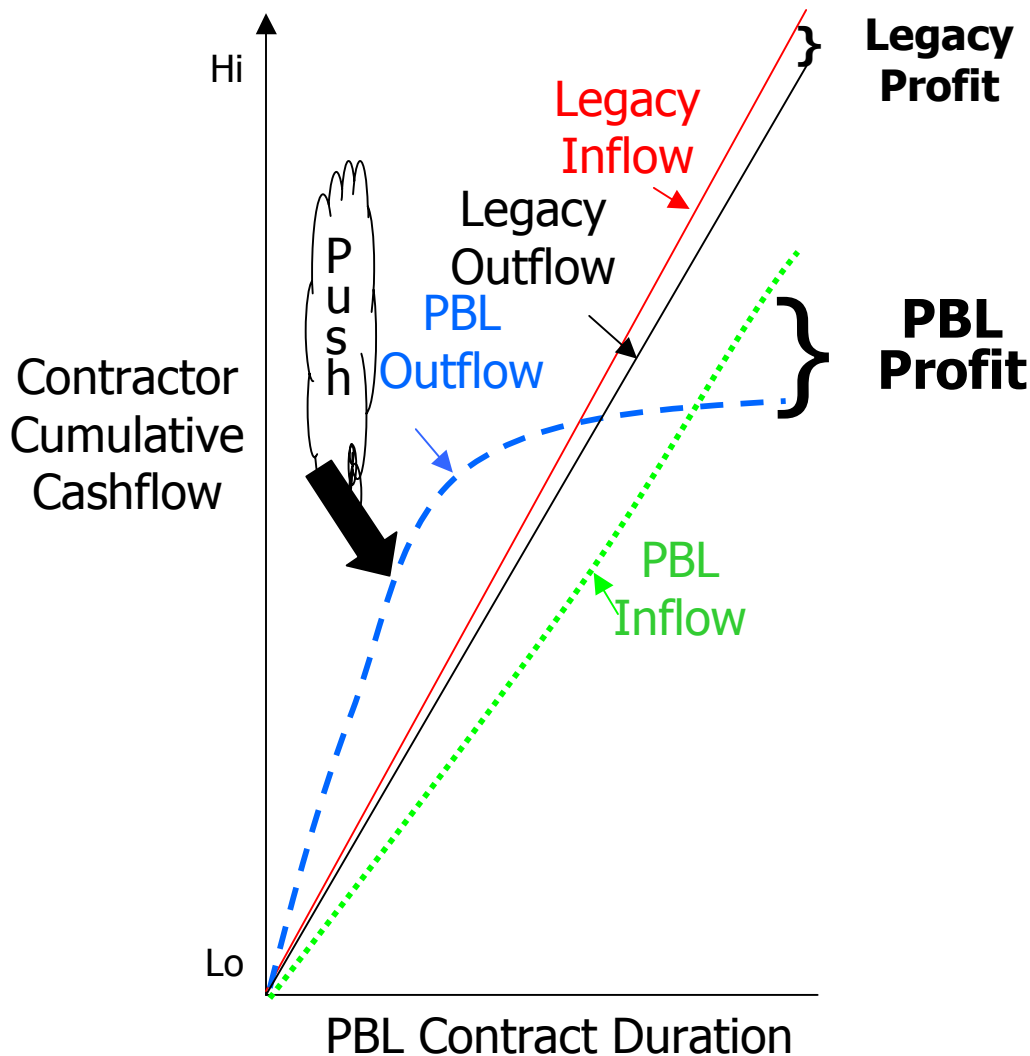
The New Revenue & Profit Mix



This type of chart helps to:

- Tell a story to top management
- Focus on PBL, as a means to increase profits
- Avoid the pitfalls of increasing revenues, but attaining low profit margins

Challenges Of Managing Cashflow



PBL offerings may require large upfront investments with revenues often significantly trailing those expenditures:
Service parts inventory, facilities, software, test equipment and others

To Be Successful, Contractors Must Have Others Who Have The Same Self Interests

- 1. *Supply chain partners;*** creates closer relationship with partners, resulting in greater profit opportunities
- 2. *Financial services;*** provides fees for creation of Special Purpose Entities (SPE), managing captive financial enterprises, issuing asset-backed securities, factoring and others
- 3. *Enterprise application software providers;*** provides new processes which will require new software codification either through modifications to current code or the issue of new modules
- 4. *Investors;*** drives higher market capitalization due to higher profit margins, faster profit growth and more stable earnings
- 5. *Accountants;*** creates more complex balance sheets and income statements which require higher diligence resulting in higher auditing fees
- 6. *Lawyers;*** creates more fees due to: more complex contracts between OEM suppliers, channel partners and customers, more legal entities for managing risk (such as LLCs, JVs partnerships) and anti-trust due diligence

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- 7. *Management consultants;*** creates new processes requiring the re-engineering of the business model, resulting in higher fees
- 8. *Stock analysts;*** changes balance sheet and income statement configuration requiring astute financial analysis leading to a greater investor following
- 9. *Trade groups;*** ensures the long-term financial health of their members
- 10. *Magazines and newspaper press;*** driver for “cutting edge” articles
- 11. *Politicians;*** ensures continuity of jobs at suppliers and depots/ALCs in territories they represent
- 12. *Unions;*** ensures stable levels of employment