Accurate
Credible
Defensible

DoNCAS Presentation:
NAVSEA Portfolio Assessment Team

Morris Fields

September 16, 2010

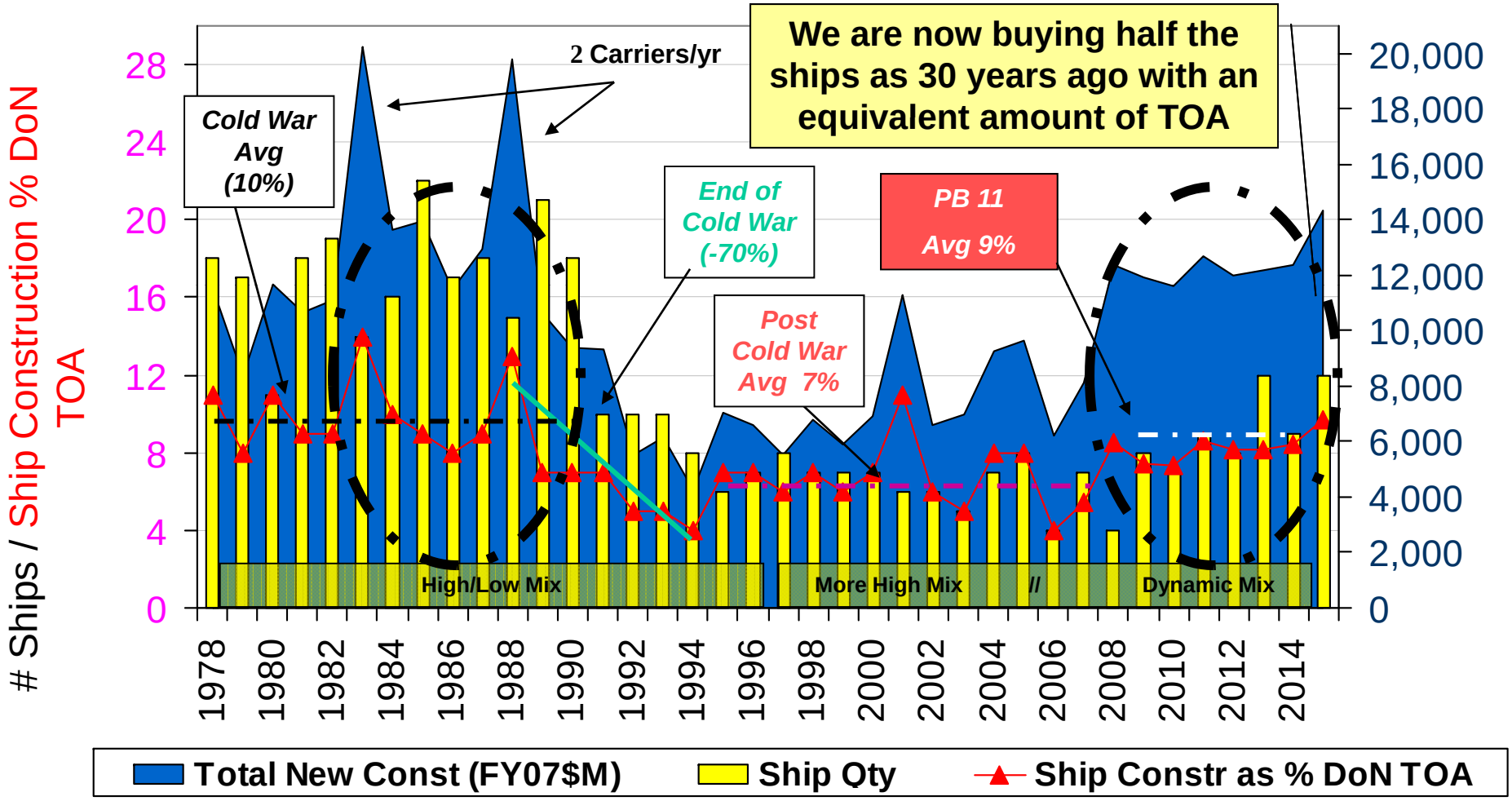
"What can we afford?"

"Our industry partners provide the Navy and the Marine Corps the most capable ships, the most capable aircraft and the most capable weapons systems the world has ever known…….But the issue is not the complexity, the issue is not the skill, **the issue is affordability.** What can we afford? As complexity has grown, so has the price. And it has grown at a rate faster than the top line that we have, a rate faster than inflation, a rate faster than anything, frankly. **We have to do everything in our power to control those cost. And I'll repeat, if we don't do something now, we won't be able to build the fleet that we have to have in the future."**

Remarks by the Honorable Ray Mabus, Navy League Sea-Air-Space Expo - 5 May 2010

We simply cannot afford to do business the same

Shipbuilding Procurement History



How are we going to buy ships more efficiently?

"What makes a difference"

"…Defense Secretary Robert Gates announced he wanted to find **$100 billion in overhead savings over the next five fiscal years**, starting in fiscal year 2012"

"…Pentagon officials have created **five teams to lead the effort to improve efficiency** across the Defense Department...each team will work on a different area that the Pentagon believes can lead to cost savings….**those areas are affordability, incentives, contract terms, metrics, and service contracts**."

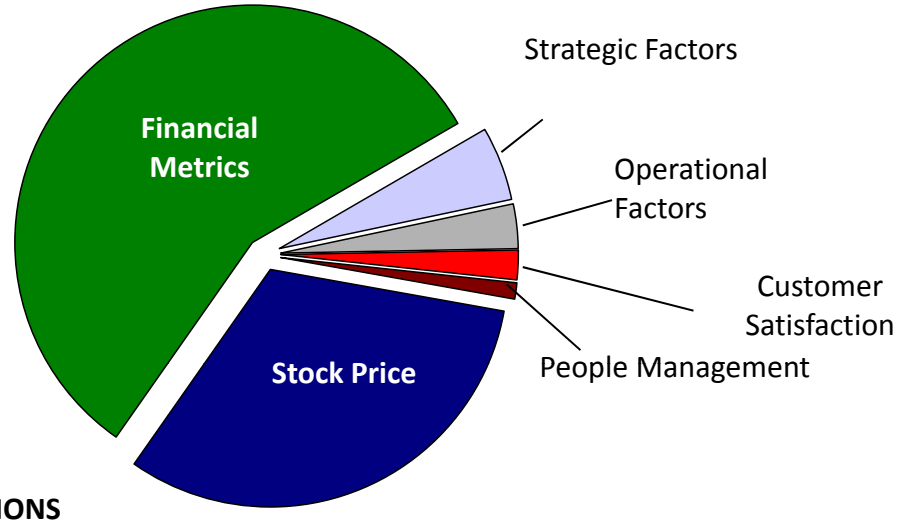
"…for incentives, **the question is what will really make a difference to the contractor**."

"…One of the things we were talking about was it might **not necessarily be a concern as to how much profit a contractor makes as long as the cost to the government is lower, the product is better and more sustainable**"

DefenseNews

What are the levers to motivate industry performance?

Defense Industry Executive Compensation



DEFINITIONS

FINANCIAL – OPERATING PROFIT, SALES, CASH FLOW, ROIC / EVA

STOCK PRICE – TOTAL SHAREHOLDER RETURN INCLUDES STOCK PRICE APPRECIATION PLUS REINVESTED DIVIDENDS

STRATEGIC – BUSINESS GROWTH, NEW CONTRACTS (WIN RATE), PROTECTION OF EXISTING PROGRAM FUNDING, ACQUISITIONS, ENHANCEMENT OF CORPORATE REPUTATION

OPERATIONAL – COST CONTROL / PRODUCTIVITY, LEADERSHIP INITIATIVES, QUALITY MANAGEMENT, ETHICS, ENVIRONMENTAL COMPLIANCE, LABOR RELATIONS, SUPPLY CHAIN MANAGEMENT

CUSTOMER SATISFACTION – EXECUTION OF CRITICAL PROGRAMS, REALIZATION OF AVAILABLE AWARD FEES

PEOPLE MANAGEMENT - ATTRACTION / RETENTION OF TALENT, LEADERSHIP DEVELOPMENT, SKILL MIXES, DIVERSITY

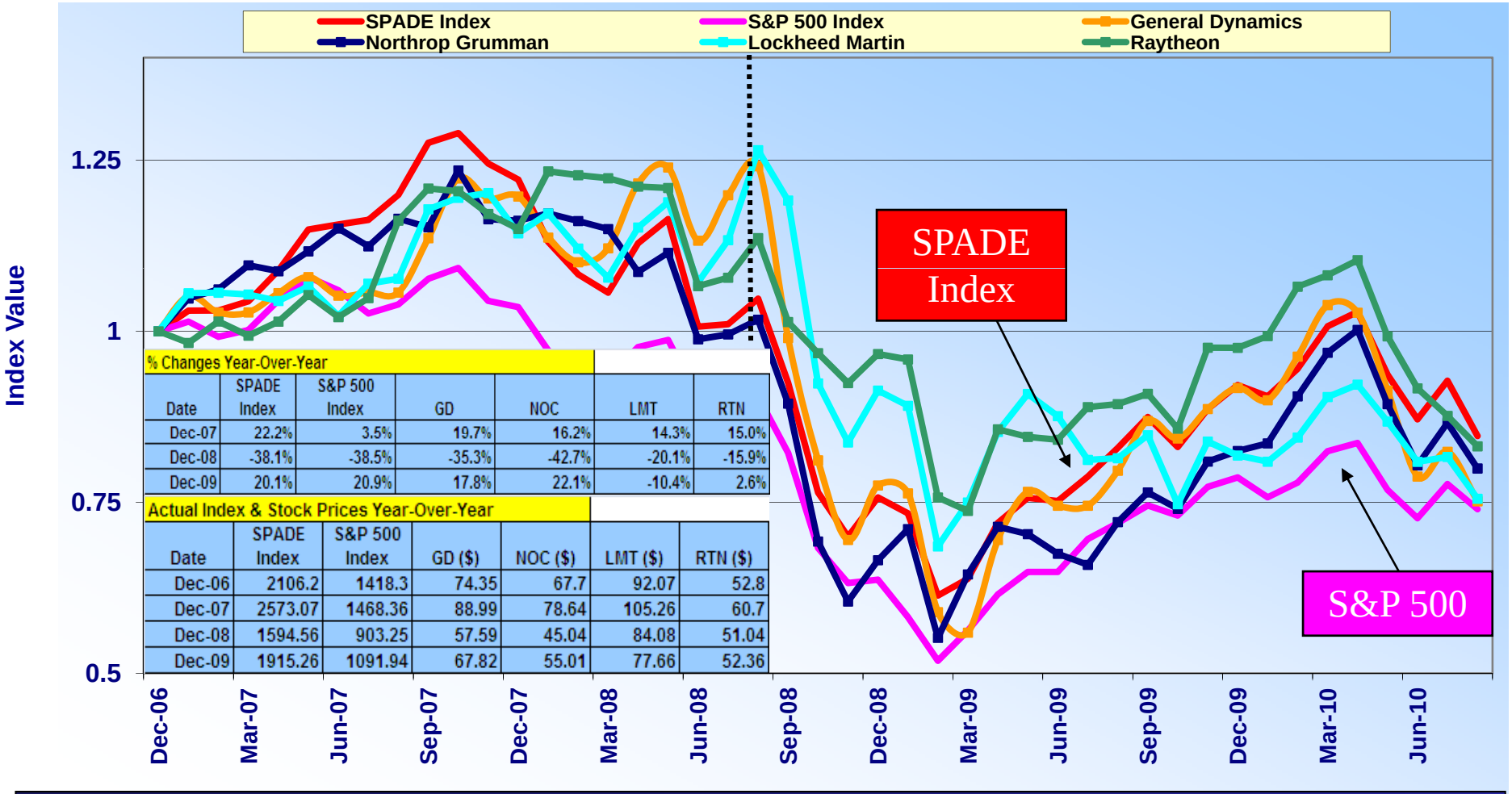
Purpose of Executive Comp

- Successful accomplishment of business goals in both annual operating performance and the achievement of increased shareholder value produce individual rewards.
- Compensation will motivate and reward executives for delivering operational and strategic performance to maximize shareholder value and demonstrating the Company's values, behaviors, and leadership competencies.
- Promote recruitment and retention of exceptional talent, to encourage behavior critical to the long term success of the Company, and to maintain a direct link between pay and individual performance.

Industry heavily incentivized to achieve financial goals and shareholder value

Big 4 Stock Prices Historical Trends

(updated 9-09-2010)



% Changes Year-Over-Year

Date	SPADE Index	S&P 500 Index	GD	NOC	LMT	RTN
Dec-07	22.2%	3.5%	19.7%	16.2%	14.3%	15.0%
Dec-08	-38.1%	-38.5%	-35.3%	-42.7%	-20.1%	-15.9%
Dec-09	20.1%	20.9%	17.8%	22.1%	-10.4%	2.6%

Actual Index & Stock Prices Year-Over-Year

Date	SPADE Index	S&P 500 Index	GD ($)	NOC ($)	LMT ($)	RTN ($)
Dec-06	2106.2	1418.3	74.35	67.7	92.07	52.8
Dec-07	2573.07	1468.36	88.99	78.64	105.26	60.7
Dec-08	1594.56	903.25	57.59	45.04	84.08	51.04
Dec-09	1915.26	1091.94	67.82	55.01	77.66	52.36

Despite poor performance on major Navy Programs stock prices continue to outperform the S&P 500

Closing the Gap

SECNAV: "...there is a limited understanding within the Department of Defense of how business operates, how it responds to competition, and how it is affected by Wall Street's expectations. The reasons for this limited understanding are not difficult to discover.

Interestingly, industry does understand the Department of the Navy. Industry hires our alumni, and runs an extensive and effective intelligence collection effort targeting us. **But the Department's acquisition program managers do not have an in-depth understanding of how industry operates, and the Department as a whole does not act strategically in dealing with industry.** It is very difficult for government to hire from industry, particularly at the more senior levels. Furthermore, we do not provide the experiences or training to our uniformed acquisition professionals that would enable them to fully understand or anticipate industry. Neither government nor business can effectively operate with this gap in the government's ability to understand business."

The Honorable Donald C. Winter, Sea Air Space Expo, 3 Apr 07

Acquisition professionals must close the knowledge gap of how their industry counterparts operate

DoD/Navy Business as percent of Company Sales

The whole is greater than the sum of its parts….

Aristotle 384 BC – 324 BC

2009 Sales Figures for the Top 6 Defense Contractors

Rank	Parent Company	Total Sales *	DOD Sales **	DoD % of total sales	Navy Sales**	Navy % of total sales
1	Lockheed Martin Corp.	$45,189,000,000	$32,673,097,518	72%	$12,420,552,504	27%
2	Raytheon Co.	$24,881,000,000	$15,339,065,095	62%	$8,235,300,511	33%
3	Northrop Grumman Corp.	$33,755,000,000	$19,467,264,517	58%	$8,043,732,268	24%
4	General Dynamics Corp.	$31,981,000,000	$14,955,700,419	47%	$6,329,300,597	20%
5	Boeing Co.	$68,281,000,000	$22,239,786,802	33%	$5,266,715,511	8%
6	BAE Systems	$22,415,000,000	$7,261,948,633	32%	$2,293,172,273	10%
	Totals	**$226,502,000,000**	**$111,936,862,984**	**49%**	**$42,588,773,664**	**19%**

* Source: 2009 Company Annual Reports

** Source: Government Executive.com 8/15/2010 (http://www.govexec.com)

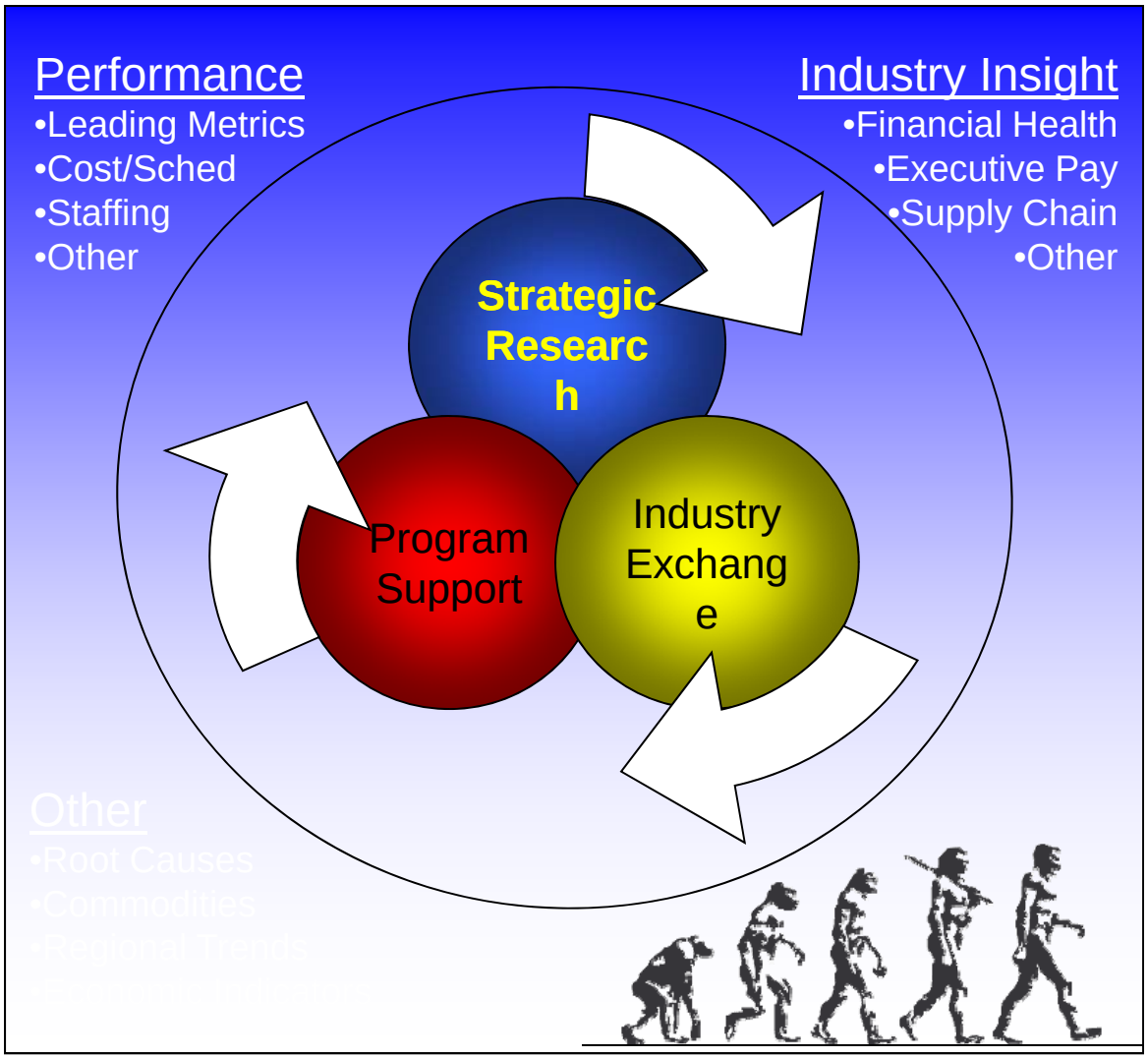
Navy provides up to 30% of annual business for Top 6 defense contractors. Why don't we have more influence?

To assert our influence we have to act as a whole (portfolio) versus a collection of individual parts (programs)

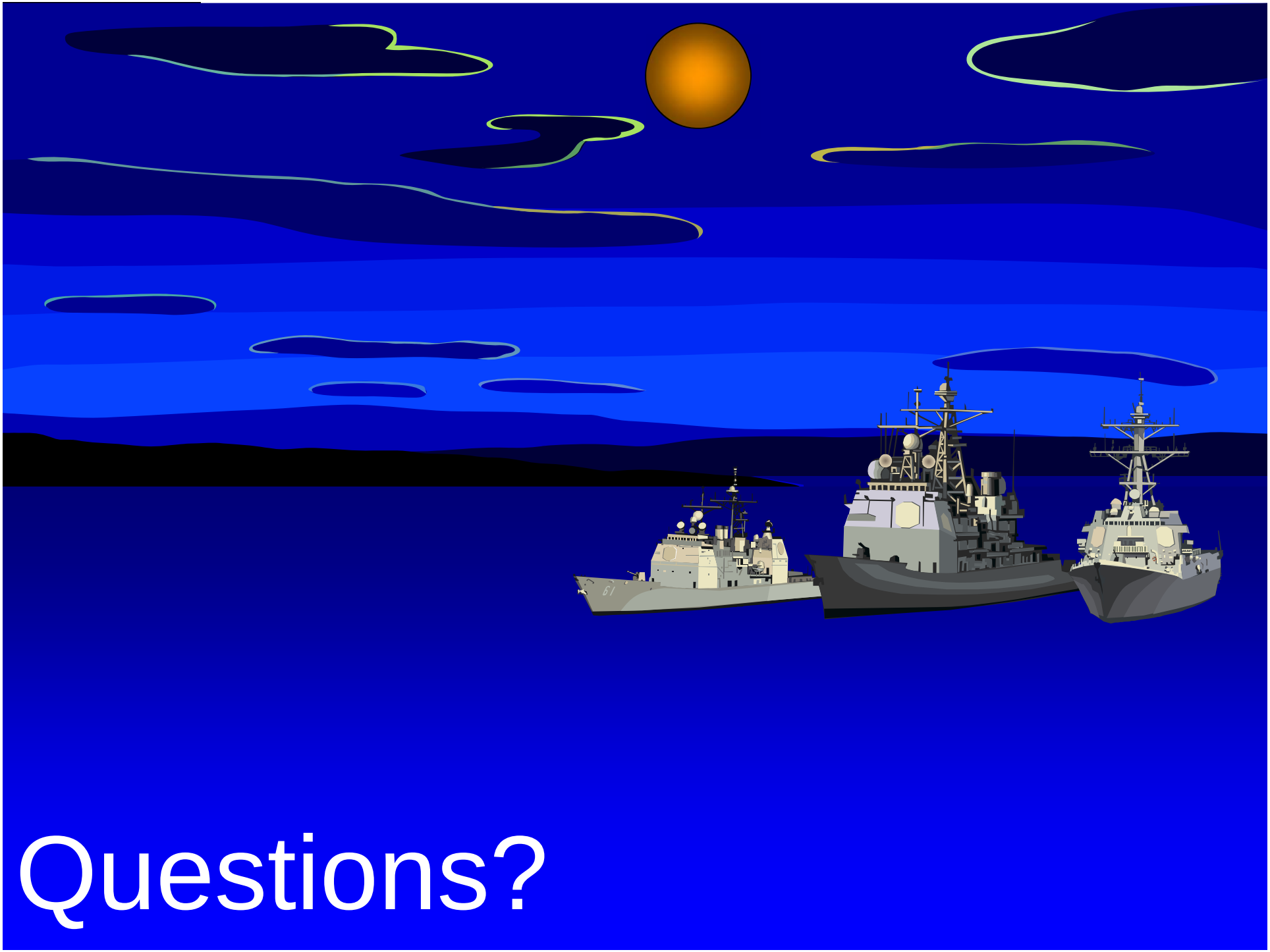
Portfolio Assessment Team

GOALS

- Increase awareness and understanding of contractor's and sub-contractor's business
- Through strategic research, find opportunities to leverage industry data, economic data, performance data, and lessons learned to reduce cost on current and future Navy programs
- Become an integral part of the analysis being used prior to and post contract award
- Evolve into an independent and reliable source for insightful analysis for our customers which will enable them to take ACTION!



TRANSFORMING DATA → INTO INFORMATION → TO TAKE ACTION

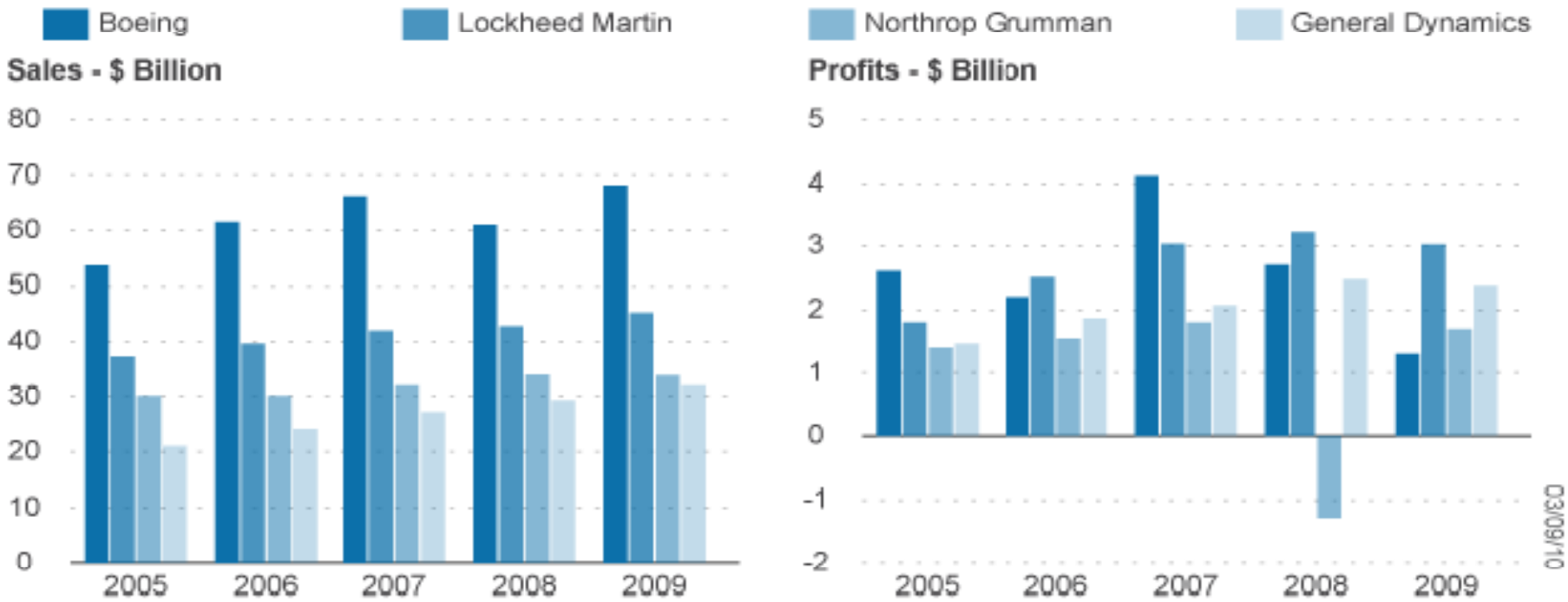


Questions?

Backup

Defense companies' sales and profits

Major defense contractors have enjoyed strong sales growth in recent years, but these companies are under a cloud now as U.S. budget growth is poised to slow and the Pentagon is looking to rein in costs.



Source: company statements and annual reports

REUTERS

Reuters graphic/Van Tsui

Big 4 Defense Companies

Firm	Current Executive	Since	Business Segment	2006 Op Mgn	2007 Op Mgn	2008 Op Mgn	2009 Op Mgn	1st Qtr '10 Op Mgn
RTN	Taylor W. Lawrence	Jul-08	Missile Systems	10.6%	10.8%	10.8%	10.9%	11.6%
	Thomas A Kennedy	Jun-10	Integrated Defense Systems	16.4%	17.6%	16.9%	15.5%	15.7%
	Richard R. Yuse	Mar-10	Space and Airborne Systems	14.0%	13.2%	13.3%	14.1%	14.5%
	Lynn A. Dugle	Jan-09	Intelligence and Information Systems	9.1%	9.0%	8.1%	8.1%	6.8%
	Colin Schottlaender	Aug-02	Network Centric Systems	10.6%	12.8%	12.7%	14.0%	14.0%
	John D. Harris	Mar-10	Technical Services, LLC	7.1%	6.4%	6.7%	6.8%	8.4%
			Operating Earnings Margin	11.0%	11.1%	11.3%	12.2%	11.7%
	Joseph T. Lombardo	Apr-07	Aerospace	15.6%	16.8%	18.5%	13.7%	16.1%
GD	David Heebner	May-10	Combat Systems	11.3%	11.7%	13.6%	13.1%	13.4%
	Phebe N. Novakovic	May-10	Marine Systems	7.6%	8.4%	9.4%	10.1%	9.8%
	Gerald J. DeMuro	Oct-03	Information Systems & Technology	10.8%	10.7%	10.7%	10.7%	10.5%
			Operating Earnings Margin	10.9%	11.4%	12.5%	11.5%	11.8%
NOC	Linda Mills	Feb-08	Information Systems	8.6%	9.3%	7.7%	7.3%	8.9%
	Thomas E. Vice	Jun-10	Technical Services	6.5%	5.7%	5.7%	5.8%	6.4%
	Gary W. Ervin	Jan-08	Aerospace Systems	9.5%	14.2%	4.2%	10.3%	11.0%
	James F. Pitts	Oct-05	Electronic Systems	11.5%	12.5%	13.4%	12.6%	12.0%
	Mike Petters	Nov-04	Shipbuilding	7.4%	9.3%	-37.5%	4.8%	6.2%
			Operating Earnings Margin	9.4%	9.6%	-0.3%	7.4%	8.9%
LMT	Ralph D. Heath	Jan-05	Aeronautics	10.0%	12.0%	12.5%	12.9%	11.0%
	Marillyn A. Hewson	Jan-10	Electronic Systems	12.0%	12.7%	13.0%	13.1%	13.3%
	Joanne Maguire	Apr-06	Space Systems	9.4%	10.4%	11.9%	11.2%	8.1%
	Linda Gooden	Jan-07	Information Systems & Global Services	8.9%	9.3%	9.3%	8.3%	11.1%
			Operating Earnings Margin	9.5%	10.8%	12.0%	9.9%	9.2%

Portfolio Analysis Team

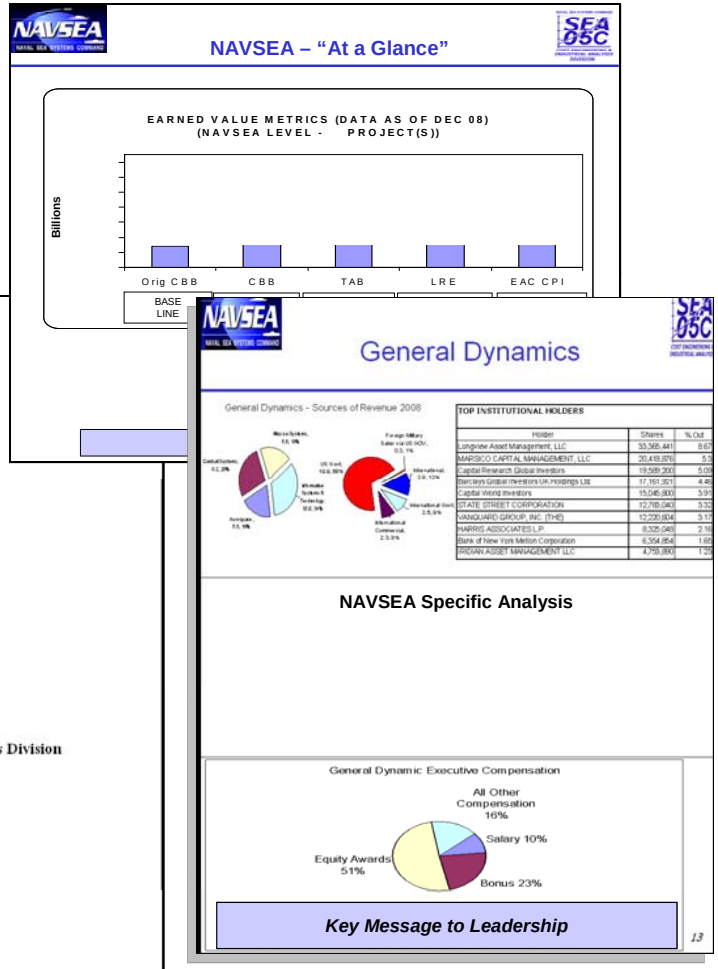
A comprehensive portfolio analysis capability will develop and evolve over time.

Industry/Regional Trends
- Industry growth/ contraction
- Unemployment rates/projections

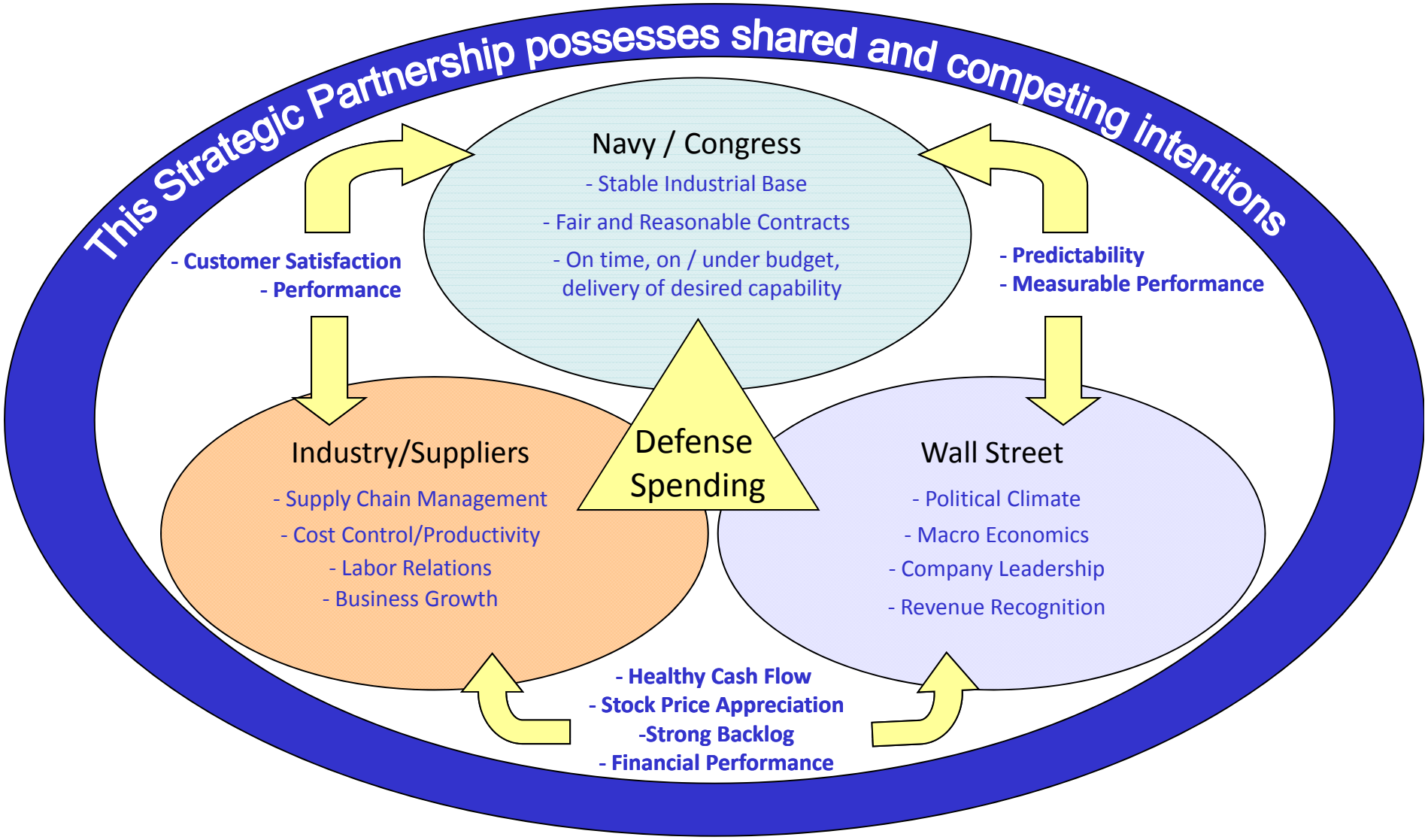
Corporate Performance
- EVM trends
- Leading indicators

Corporate Awareness
- Financial Health
- Executive Compensation/Motivation
- Sales/Revenue growth/Profit Margin
- Growth projections
- Active contracts
- Subcontractors

- LCCE Assumptions
- Risk analysis
- Contract negotiations
- EVM projections
- Executive Discussions



A comprehensive portfolio analysis will inform stakeholders within the acquisition and cost estimating processes

TRANSFORMING DATA → INTO INFORMATION → TO TAKE ACTION

Navy, Industry and Wall Street Goals