

It's no secret that the Pentagon has gotten religion. Spurred by the teachings of Defense Shepherd Gates, the Pentagon's acquisition flock has begun to chant the two-tone mantra of "efficiency and affordability". We've reported on this new (or re-learned) religion [before](#), and we'll have more to say about it in the near future. But today's article is about how some of the leaders in the defense industrial base are reacting to pressure from the zealous Pentagon faithful.

The contractors are reorganizing and cutting staff.

But first we need to be intellectually honest and admit that some contractors have been making adjustments for many months, and these changes we report today are but the latest in a series of intricate steps designed to position the companies for future dances with their favorite partner, the Department of Defense. For example, we reported [here](#) about cutbacks at Northrop Grumman's Gulf Coast shipbuilding businesses and about cuts to Navistar's MRAP production staff.

[Over here](#), we reported on a reorganization at BAE Systems and a planned early retirement buy-out offer for Lockheed Martin executives. And those are just two of the many stories we've posted about how defense contractors are adapting to the changing economic reality of the post-Bush, post-Iraq defense acquisition environment. So let's be clear: today's stories are nothing new, nothing out of the ordinary. But they *are*

illustrative of what's happening in the A&D industry.

Lockheed Martin

As noted above, we previously reported on LockMart's early July 2010 announcement of early retirement incentives (the "Voluntary Executive Separation Program," or VESP) to be offered to Directors and Vice Presidents who, if they accepted, would need to exit the company by February 2011. We reported that LockMart hoped to thin its executive ranks by about seven percent.

On September 8, 2010, Bloomberg [reported](#) that "about 25 percent" of the company's executives had accepted their VESP offers. According to the article, "More than 600 vice presidents and directors applied for the program ... [and] all will have gone by February." According to the Bloomberg article—

The severance program will yield 'substantial savings' starting in 2011, Lockheed said. It also will provide 'a leaner management structure at a time when our customers have an urgent need for more affordable solutions to the global security challenges they face,' Chief Executive Officer Bob Stevens said.

Certainly, Lockheed Martin will see a reduction in current compensation costs from the departures. But at what cost? According to this [Washington Post](#) article, the company's September 13, 2010 filing with the SEC estimated that it would record a one-time charge of between \$175 and \$200 million for the severance packages. According to the Post's math, "Based on that figure, the average cost per employee could be as much as \$333,000." The article continued—

Lockheed's filing details how the payments will be made. An individual's lump-sum payment is broken into three elements: 75 percent to 125 percent of the executive's annual salary, based on years of service; a payment of \$2,000 per year of service, up to 30 years, meant to defray future medical costs; and an amount equal to the executive's 2011 vacation pay.

Additionally, executives who take the buyout will remain eligible for bonuses early next year based on their 2010 performance. ... The severance payment will be made within 90 days of an executive's departure.

That's a pretty sweet deal, if you ask us. And very likely 100% allowable, as well. But we haven't seen any inquiries regarding whether the result of LockMart's VESP--which were more than 300 percent better than its planned outcome--was a good thing or really just another problem that has been deferred and will surface in a few years? Is the company really saying that it can cut 25 percent of its executive ranks and not miss a beat? Wow, that's kind of a message right there

Boeing

The No. 1 Aerospace/Defense company in the world also reported some changes to its Military Aircraft business, so as to "continue to position the company for growth in the current business environment," according to this Boeing [press release](#) . The reported changes include consolidating six divisions into four and ten percent cuts to the BMA executive ranks. The press release adds that, "Additional reductions across all levels of the organization are

Written by Administrator
Thursday, 16 September 2010 00:00

anticipated in coming months.” The press release included a statement of BMA’s strategic intent—

In announcing the changes, Boeing Military Aircraft President Chris Chadwick said the new organization will allow BMA to meet domestic and global defense requirements for the next 10 years and beyond.

‘This new structure supports BMA’s progression from a product-based business to a capabilities-based business, focusing on supporting our customers in the United States and increasingly important international markets,’ Chadwick said. ‘It is consistent with initiatives under way throughout the entire Boeing defense business that will allow us to remain competitive and grow.’

Frankly, we’re not 100 percent sure what Chadwick’s statement means. But we think it means that Boeing may be finally admitting that it won’t be making too many new military aircraft in the foreseeable future. With the end of the C-17 program in sight, and the F/A-18 program focused on international sales, and LockMart firmly in the F-35 driver’s seat, Boeing may be admitting that its military aircraft business is going to inevitably shrink—significantly—in the near future.

In related news, [remarks](#) by Boeing Defense President Dennis Muilenburg fueled rumor and speculation that the company might make a play to acquire some or all of Northrop Grumman. Reuters reported—

Defense analyst Loren Thompson said weapons demand fell by 50 percent during the last two downturns, spurring earlier consolidation, and the same could happen again this time. ‘That means that at least one of the big players will have to exit if we are facing a similar downturn in the years ahead,’ Thompson told the Reuters Summit.

‘There's not enough business to go around,’ said one former senior military official who now works in industry, but who was not authorized to speak on the record.

Northrop Grumman Corp would be a good fit with Boeing, although there could be antitrust concerns about the two companies' space operations, Thompson said. ‘Boeing has a big revenue shortfall on the defense side that it needs to cover. Buying part or all of Northrop could fix that problem, while giving it entry into the Joint Strike Fighter program,’ Thompson said, referring to the \$380 billion Lockheed Martin Corp F-35 fighter program. Northrop has a large role on the program, which Lockheed beat out Boeing to win in 2001

On the other hand, given the Obama Administration’s focus on increasing competition in the defense marketplace, as well as potential anti-trust issues, we don’t see this as a likely outcome.

BAE Systems

On September 11, 2011, the Wall Street Journal [reported](#) that BAE Systems was going to put “parts of its North American commercial aerospace business up for sale in an auction.” The article asserted that the sale could “fetch up to \$2 billion.” The article stated that—

BAE, Boeing & Lockheed Martin React to New Economic Reality in Different Ways

Written by Administrator

Thursday, 16 September 2010 00:00

One of the units on the block makes aircraft-engine controls for General Electric Co. The other units include a commercial avionics business and a division that makes hybrid propulsion systems for buses and trucks,

According to this article at [Forbes](#), “BAE is reportedly looking to focus on its support and maintenance operations.”

We’re not sure what conclusions one can draw from the foregoing news snippets. But we’ll have more reorganization, layoff, and M&A activity to report this year—we’re sure of that.