

STATEMENT OF ROBERT J. STEVENS

CHAIRMAN AND CHIEF EXECUTIVE OFFICER

LOCKHEED MARTIN CORPORATION

BEFORE THE HOUSE ARMED SERVICES COMMITTEE

JULY 18, 2012

Mr. Chairman, Ranking Member Smith and Members of the Committee:

On behalf of the 120,000 men and women of Lockheed Martin that I am so very privileged to represent, thank you for the opportunity to share our views on the impacts of sequestration. We strongly believe this represents the single greatest challenge faced by our company and our industry.

We understand the fiscal pressures our nation faces, and we are 3 years into an aggressive effort to reduce costs and better align ourselves to these budget realities. We have reduced our overhead, cut capital expenses, curtailed research and development, consolidated facilities, and engaged in very painful but necessary reductions in personnel across our company. And we'll continue to do more, because we understand the need to be more affordable, more efficient, and more effective.

To illustrate this commitment, over the past three years alone, we have reduced costs by billions of dollars. We've removed a million and a half square feet from our facilities' footprint, and we will reduce another 2.9 million square feet before the end of 2014. Most painfully, today our workforce is 18 percent smaller than it was just three years ago. That means we have 26,000 fewer employees today, and the pace of our hiring has slowed considerably.

We know that program execution is critical to delivering affordable products and services to our customers ... and we stay focused on that priority

every day, because that's how we deliver value to our customers which enables us to return value to our shareholders.

Yet, our ability to continue this orderly process of reducing cost while continuing delivering to our customers the best technology and security capabilities in the world is under direct jeopardy by the arbitrary and uncertain consequences of budget sequestration. Despite assurances by some that sequestration is not likely to happen, it is the law of the land and we have no choice but to do our best in planning for its execution. Accordingly, if sequestration occurs in January of next year, it will result in cuts of about half a trillion dollars each in defense and non-defense accounts over the next nine years. For defense, that's an additional half trillion dollars beyond the Budget Control Act commitments already in place to reduce defense by \$487 billion over 10 years beginning this year.

Secretary of Defense Panetta has spoken in the strongest possible terms against sequestration. He said this process will have catastrophic consequences for our national defense and called it a "meat axe". It is. By its very nature, the sequestration process would occur independent of any correlation with strategy, force structure, technology needs or operational reality.

My purpose here today is not to attempt to speak for our government customers. But we certainly closely listen to them as to what they need and why. We know they invest a considerable amount of time examining the global security

environment, the technologies and capabilities they will need, and how that flows into recapitalization programs.

In the new national security strategy, the President and the Secretary of Defense have spoken extensively about those requirements. And sequestration doesn't align with any of them. That is one of our great concerns about sequestration. It's not aligned with the national security strategy. It's not aligned with technology evolution. It's not aligned with mission areas.

From an industry perspective, because of the specter of sequestration, the near-term horizon is completely obscured by a fog of uncertainty. With just 167 days remaining until it is triggered, we have little insight as to how sequestration will be implemented ... no insight into which programs will be curtailed, which sites will be closed, which technologies will be discontinued, or which contracts will be reformed. Nor do we know which suppliers – particularly our small business participants, who are so vital to our supply chain – will be shut down or crippled. And most tragically, we can't reliably estimate how many people will be affected. How many dedicated employees are going to lose their jobs? How many family lives are going to be disrupted?

Some may consider it flattering to believe that our industry is so robust and so durable that it could absorb the impact of sequestration without breaking stride. But this is fiction. The impact on industry would be devastating, with a significant disruption to ongoing programs and initiatives, leading to facility

closures and personnel reductions that would significantly disrupt advanced manufacturing operations, erode engineering expertise, and accelerate the loss of skills and knowledge. It would also directly undermine a key provision of the new national security strategy, which is to preserve the industrial base, not dismantle it. We fear our industry – which is a crown jewel of the American economy -- will suffer a loss of learning, a depletion of talent, and erosion in quality.

In fact, the very prospect of sequestration is already having a chilling effect on the industry. Our ability to hire the best and brightest is being hurt. We're not making as many discretionary investments. We're not leaning forward. We're reducing our training programs. All because of the uncertainty associated with sequestration's sudden and arbitrary additional cuts in next year's defense budget. It's a huge disruption to our businesses.

Beyond the defense industry, the broader consequences of sequestration, in my opinion, are also not well understood. Contrary to the popular perception, sequestration does not only affect defense accounts. It affects non-defense discretionary accounts as well. And since most of those departments and agencies don't have substantial capital acquisition accounts like the Department of Defense, that means these cuts are likely to fall more heavily on the "people accounts" through significant unpaid furloughs and personnel reductions. This will constrain agencies from providing essential support and services, and severely hurt their ability to properly fulfill their missions.

Unless this law is changed, we're probably going to see a reduction in the number of FBI agents that are on the job, the number of Border Patrol officers who are available, the number of people who process social security claims, the number of air traffic controllers, Coast Guardsmen, TSA agents, and so many more people whose jobs will be cutback. These are very real, direct implications of sequestration that many people don't fully appreciate. Taken together, we agree with the emerging assessment that sequestration would have extremely adverse impacts on our U.S. economy at a critical time.

In terms of how sequestration will actually be implemented, what we know are the basic facts on when it is supposed to take place and the aggregate figures involved. Beyond that knowledge, we don't have authoritative guidance on how sequestration will be implemented or the mechanics of this process. There are many important implementation questions yet to be answered that will affect significantly how the sequestration process unfolds.

We do know, however, that we have responsibilities under the Worker Adjustment and Retraining Notification Act – the WARN Act – that require us to notify workers in advance of plant closings or significant layoffs. Under the law, we must give affected employees 60 days' notice in most states and 90 days' notice in New York.

That establishes a framework where we're compelled to start talking to our employees and our 40,000 suppliers, who want to know, “am I going to have a job in January,” and “am I going to have a contract in January?”

And the answer from us today is we're not clear about that. We know it's the law to notify many of them in advance, and we know we'll comply with the law. Our best estimate at this point is that defense sequestration is likely to result in about a 10 percent, across-the-board reduction, at the program, project and activity level for most accounts, which means it could be peanut butter spread set of cuts across most of our contracts. We have seen higher estimates and lower estimates depending on how the Administration chooses to implement the Act. But as responsible business leaders we must do the best we can to prepare for this coming reduction. The law, prudence, good corporate governance, and our integrity require that of us.

But without additional guidance on how or when cuts will be implemented, the modeling that we're undertaking lacks clarity in many cases. Based on the limited information available to us and taking into account the allocation of our business among DOD, other U.S. Government and commercial work that will not likely be impacted, a very rough "seat of the pants" estimate is that we might be required to lay off about 10,000 employees. This number is derived by assuming a 10% across-the-board cut in the DOD budget and an 8% across-the-board cut in non-DOD governmental budgets and reflects the fact that approximately 60% of our business is with the DOD and approximately 20% is with non-DOD governmental entities.

But which 10,000? And when? That is difficult to determine without additional guidance from the Government that allows us to narrow the potential

impacts. We don't know with much precision yet which lines of business, which sites, which contracts, which programs, or which technologies would be affected. But when we do know the details, it is in the Government's interest and frankly our employees' interest that we be prepared to move out immediately and without delay. Since these reductions involve a defined dollar amount for the fiscal year, every day or week of delay in making necessary cost reductions can mean even deeper cuts might be required later in the fiscal year, or production costs will be higher than necessary and there will likely be a dispute as to who will pay for these costs. So our judgment is that we need to be ready to act as closely as possible to "day one" of the Act.

One thing we are reasonably certain about is that reductions of this magnitude are likely to trigger the law – the WARN Act – requiring 60 days or more advanced notification in certain locations before workers can be laid off. But since we don't exactly know who will be affected by layoffs, or whether any plant closings will be necessary absent legal or contractual relief, our best judgment is that we may have to notify a substantially higher number of our employees beginning late in the third quarter of this year that they may not have a job if sequestration takes place. We do not look forward to making those notifications. But we have a legal and ethical obligation to tell our employees what we know and what we can share. We'd very much prefer to give them more clarity and more details because they have a right – the law gives them that right – to know that their jobs are potentially at risk.

We may also conditionally notify our suppliers that the contracts we have with them may or may not be impacted by sequestration. Our suppliers are already asking how they should price their work. If they're bidding a job with us and the job goes on for three years in the future and that starts in 2013, should we include the consequences of sequestration to our cost structure in that bid, or should we not? Or should we propose a re-opener provision? It's very murky right now, and we don't think there's going to be uniformity across the industrial base until we get much more refined guidance about how sequestration would be precisely implemented.

Throughout our supply chain, many of our suppliers, through our drive for affordability and alignment with Pentagon expectations, have worked to lower their costs and provide the most affordable prices for our high-technology products. They've done that with an expectation within reasonable boundaries of what the future business environment will look like. If sequestration occurs in January, the expectations upon which that cost and pricing structure have been built will be off the table.

Another question will be, how will the contracts be modified? And when we have a modification of our contracts, are we going to re-phase and reschedule, in our case, up to 40,000 suppliers? Our sense is, those 40,000 companies will assert that is a business disruption and we are going to make a claim for the adverse cost impact of the disruption in that business. This has happened before, even when individual contracts are modified. And then we'll be

compelled to assemble this portfolio of requests for equitable adjustments or claims and pass that along, as the prime contractor to our government customers.

We have no guidance on how that number of requests for equitable adjustments and claims will be managed, so it's just not clear to us, and more importantly, it's not clear to our small-business suppliers. That really puts them under an enormous amount of pressure and for some, will put their businesses at risk.

If sequestration happens, we will comply with the law respectfully and as ably as we can. But if sequestration is going to happen, the sooner we get clarifying and implementing guidance, the better.

For the reasons outlined here, we firmly believe that sequestration is wrong for the country, wrong for the industry, wrong for the people of Lockheed Martin. In summary, it's the wrong process through which to try to secure greater reductions in spending. We firmly believe we must not let an automatic budget trigger – a default position – become the dominant force for allocating resources and shaping our nation's security posture.

If sequestration happens, it will be a blunt-force trauma to industry and to America. We're concerned that it will tear the fabric of the supply chain, the industrial base and our national security in significant and irreparable ways. The evidence is compelling.

Multiple credible studies point to the potential for the loss of up to two million jobs as result of sequestration. The new national security strategy, according to Secretary Panetta, will be unachievable. We'll lose the ability to gainfully employ adequate numbers of engineers, scientists, and mathematicians just when we need more of each to maintain our competitiveness as a nation. We think about that every day, because the long-term health and vitality of our economy, of our ability to provide for our security and provide for our citizens, is based entirely on our ability to be competitive in the 21st century.

We have had meaningful discussions with the Administration, the Congress, and others, and we will continue to have those conversations in hopes that a comprehensive and integrated solution can be found to avoid this disaster.

I don't profess to have the wisdom or expertise to give counsel to this Committee or to the Congress on the precise path forward to resolve all the fiscal challenges facing our nation. But I have spent decades of my professional working life in the national security arena and I have never been as concerned over the risk to the health of our industry and our government enterprise. Sequestration has been described many times to me as a "doomsday device" as a threat designed to never happen. But the effects of sequestration are being felt, right now, throughout industry. Every month that goes by without a solution is a month of additional uncertainty, deferred investment, lost talent and ultimately increased cost.

Respectfully, I urge you to take action to stop the sequestration process and ask that you do so soon.

The invitation to testify identified Rule 11, clause 2(g)(5), of the Rules of the U.S. House of Representatives for the 112th Congress which requires nongovernmental witnesses appearing before House committees to include in their written statements a curriculum vitae and a disclosure of federal contracts received.

Attached is my bio, along with a summary disclosure of the value of Lockheed Martin contracts received from the U.S. Government during the prior two years. Lockheed Martin is the single largest federal contractor with over 10,000 contracts.

Calendar Year 2011

Department of Defense -	\$32,548 Million
NASA -	\$1,449 Million
Department of Homeland Security -	\$566 Million
Civil/Other US Government/Intelligence -	\$5,925 Million
Total U.S. Government Contracts Order Value -	\$40,488 Million

Calendar Year 2010

Department of Defense -	\$28,869 Million
NASA -	\$1,319 Million
Department of Homeland Security -	\$488 Million
Civil/Other US Government/Intelligence -	\$7,615 Million
Total U.S. Government Contracts Order Value -	\$38,291 Million