



# Driven by crises

U.S. defense industry eyes innovation, foreign sales; commercial sector sees growing demand

**T**op government officials and executives from U.S. and European aerospace and defense firms addressed the myriad of significant challenges facing the global aerospace and defense industry at the 10th annual Reuters Aerospace and Defense Summit. On the agenda: the engine failure that grounded Lockheed Martin Corp's F-35 Joint Strike Fighter for several weeks this summer, the policy implications of a spate of recent airline disasters, and a fresh drive by critics to dismantle the U.S. Export-Import Bank, a key source of financing for customers seeking to buy Boeing Co commercial airplanes.

Pentagon officials and executives from Lockheed Martin, engine maker Pratt & Whitney, and Britain's BAE Systems offered insights on the world's biggest weapons program – a \$400 billion effort to develop a new multirole fighter that will replace over a dozen plans now in use around the world. Speakers also addressed the sustained crises in Ukraine, the Middle

East and Africa and their impact on both U.S. foreign arms sales and U.S. military spending levels. There was broad consensus that demand for U.S. weapons could rise as a result of the turmoil globally, and that the crises could help stave off further mandatory military spending cuts that are due to resume in fiscal 2016.

On the commercial side, summit guests debated the merits of the Export-Import Bank and examined burgeoning demand for commercial airliners. Speakers took a closer look at progress on a mammoth overhaul of the U.S. air traffic control system that helps airlines navigate crowded air routes – a project that requires about \$1 billion a year in spending.

The Summit generated exclusive stories, online videos and investable insights – immediately available only to Thomson Reuters clients. Key interviews were broadcast on Reuters.com and Insider with select guests also conducting live chats directly with clients via the Global Markets Forum.

Two U.S. Air Force F-22 Raptor stealth jet fighters fly near Andersen Air Force Base in this handout photo dated August 4, 2010.

**REUTERS/U.S. AIR FORCE/  
MASTER SGT. KEVIN J.  
GRUENWALD/HANDOUT**

# Budget cuts seen endangering U.S. defense innovation

BY LEWIS KRAUSKOPF  
WASHINGTON, 1 SEPTEMBER 12, 2014

**S**py planes that fly at hypersonic speeds. Missiles with surgical-strike capabilities. Lasers that protect ships from drones and small attack boats.

These inventions and developing technologies are some of the projects that excite top military officials and defense company executives when they contemplate advances for national security.

But when they dream of the next generation of weapons and other defense products, their visions are clouded by U.S. budget realities.

Military funding for research and development has already been cut by a fourth, and faces further erosion should lawmakers let stand the sequestration law that sets up automatic cuts in defense spending for the rest of the decade.

"Cuts in the government R&D budget are very worrisome, and it is not a long-term sustainable trend for the country," Boeing Co (BA.N) President and Chief Operating Officer Dennis Muilenburg told the Reuters Aerospace and Defense Summit this week.

Sequestration will be "devastating to industry in the long term," he added, and should it lead to research cuts, in the long run it "will turn into a security issue for our country."

The Pentagon's chief weapons buyer, Frank Kendall, last week told a defense conference that the U.S. Department of Defense's research budget is \$60 billion, down \$20 billion from its peak, which he described as a major cut that threatens to delay modernization of military systems.



Boeing Vice Chairman and President Dennis Muilenburg during the last day of the Reuters Aerospace and Defense Summit in Washington September 11, 2014. **REUTERS/LARRY DOWNING**

U.S. officials have vowed to protect research in several key areas but say that funding levels were ultimately up to lawmakers, whose reluctance to allow base closures, changes in military pay, or retirement of specific aircraft fleets has put disproportionate pressure on R&D and procurement.

"What you need to jump-start innovation is to spend more money," said Loren Thompson, chief operating officer of the Lexington Institute, a think tank based in Arlington, Virginia.

"From Thomas Edison to Elon Musk, the thing that got people out and innovating was the prospect of making money," Thompson told the summit. "So if they're not going to add any money, and right now

the Budget Control Act won't let them, then chances are we're not going to get much more innovation."

One risk from lower R&D spending is failing to attract talented workers by limiting the research projects that could draw them to the industry, said Marion Blakey, president of the Aerospace Industries Association trade group.

"For the first time ever, we do not have a military aircraft in development," Blakey said. "If you are a young engineer, you want to take your talents where you're going to see results and you're going to see great opportunities."

Navy Secretary Ray Mabus said the government has been trying to protect weap-





A U.S. Air Force A-10 Thunderbolt aircraft from Bagram Air Base flies a combat mission over Afghanistan, in this handout photograph taken on June 14, 2009 and obtained on May 20, 2014. **REUTERS/STAFF SGT. JASON ROBERTSON/U.S. AIR FORCE/HANDOUT VIA REUTERS**

ons funding, and is “scrubbing the research budget pretty hard” to weed out spending on projects that have little bearing on national defense.

“What we’re also trying to do is look across research and development ... to see OK, if this works, if this matures, if this comes to pass, is it going to help us?” Mabius said.

For example, Mabius pointed to new naval technologies, such as a laser weapon on the warship Ponce in the Gulf designed to deter drones or small boats.

“You shoot a missile, it costs you a million bucks or so. You shoot a laser, and it costs you about 50 cents,” Mabius said.

Boeing’s Muilenburg said that despite

the government pressures, his company has increased its spending on defense research, choosing instead to cut overhead in its defense business. He eagerly ticked off a number of advances in Boeing’s defense and space business, including an unmanned liquid hydrogen-powered vehicle with water vapor emissions that he called “the ultimate clean airplane.”

Precision-guided weapons ranked as among the new technologies that excite Jerry DeMuro, who leads the U.S. operations of Britain’s BAE Systems Plc (BAES.L).

But DeMuro said the company plans to maintain its research and defense spending at its current percentage of revenue, noting the uncertainty of defense spending and

where sequestration cuts will hit.

Orlando Carvalho, who leads Lockheed Martin Corp’s (LMT.N) \$15 billion aeronautics division, said his company had several important projects in the works, including its SR-72, an unmanned aircraft that would fly at up to six times the speed of sound. But he declined to provide any further details since those programs are classified.

“Unfortunately, not a lot I can say about it,” he told the summit.

*Additional reporting by Andrea Shalal in Washington; Editing by Alwyn Scott and Jonathan Oatis*

# US weapons makers sense rising demand for air defense systems, tanks

BY ANDREA SHALAL  
SEPTEMBER 16, 2014

**M**ilitary crises around the world are boosting foreign demand for U.S. weapons, especially air and missile defense systems, spy equipment and armored vehicles, according to the U.S. government and industry officials.

Weapons makers like Lockheed Martin, Northrop Grumman, Boeing and Raytheon anticipate new markets for their goods, which could help offset lower U.S. military spending.

The Ukraine crisis is reviving long-dormant European demand, while the emerging threat from militant groups like Islamic State in Iraq and Syria has underpinned already strong Middle Eastern demand.

And in Asia, China's military buildup and tensions with its neighbors are prompting the United States to deepen relations with traditional allies such as Japan, and forge deeper bonds with other countries, including former foes such as Vietnam.

"Any time there is this type of turmoil like we have today in the world ... the potential is there for more demand," Orlando Carvalho, executive vice president of Lockheed's aeronautics division, said during Reuters' Aerospace and Defense Summit in Washington last week.

Lockheed's aeronautics division is likely to boost revenues to \$15 billion this year from \$14 billion, buoyed by growing F-35 jet orders. Carvalho said foreign sales could grow to more than 40 percent of the division's sales over the next year, up from the mid-30 percent range now.

While President Barack Obama's decision to step up air strikes against Islamic State militants in Syria and Iraq will prob-



Three F-35 Joint Strike Fighters (rear to front) AF-2, AF-3 and AF-4, can be seen flying over Edwards Air Force Base in this December 10, 2011 handout photo provided by Lockheed Martin.

REUTERS/LOCKHEED MARTIN/DARIN RUSSELL/HANDOUT

ably not have a material effect on most U.S. contractors, it underpins the overall sector, industry executives said.

William Loomis, managing director of investment bank Stifel Nicolaus, said U.S. actions to combat Islamic State could boost companies like ManTech International, Leidos and Engility, which provide war-related support services for vehicles and data analysis.

AeroVironment, which builds handheld drones; ammunition maker Alliant Techsystems and Exelis, which does support work in the Middle East, could also benefit, Loomis said in a research note.

Russia's intervention in Ukraine has prompted NATO members to pledge to raise defense spending to about 2 percent of gross domestic product within a decade

- another factor that could undergird demand, U.S. government and industry executives said.

However, it can take months or even years to translate foreign interest into U.S. orders.

Rear Admiral James Shannon, deputy assistant secretary of the Navy, told Reuters there has been a sharp increase in inquiries from European allies since January.

"There's a lot of information gathering," he said, noting that being able to operate similar equipment offered allies an advantage in any joint military action. "There's a lot of interest in partnering with the United States."

Heidi Grant, Air Force deputy undersecretary for international affairs, said turmoil around the world had yet to generated





Workers can be seen on the moving line and forward fuselage assembly areas for the F-35 Joint Strike Fighter at Lockheed Martin Corp's factory located in Fort Worth, Texas in this October 13, 2011 handout photo provided by Lockheed Martin. **REUTERS/LOCKHEED MARTIN/RANDY A. CRITES/HANDOUT**

new orders, but added she was seeing more collaboration and cooperation among militaries than ever before.

Many countries were looking for new intelligence-gathering equipment, aerial refueling capabilities, systems to ensure "command and control" and military transport planes, Grant told the annual Air Force Association conference.

The costliest U.S. weapons program is Lockheed's F-35 Joint Strike Fighter, jointly developed by the United States and eight allies: Britain, Australia, Canada, Turkey, Italy, Norway, Denmark and the Netherlands.

Ten countries have already decided to buy the jets. South Korea is expected to fi-

nalize an order for 40 jets this year.

Others, including Finland, Poland and Belgium, have requested and received information about the jets, said Rear Admiral Randy Mahr, deputy director of the F-35 program. Mahr said he expected additional demand to emerge in coming years.

Senator John McCain told a Washington think tank last week that India was also interested in the F-35s, but Mahr said no formal briefing had yet been provided to that country.

Greg Kausner, deputy assistant secretary of state for regional security, said the State Department was studying whether the evolving threats should shift which weapons systems could be sold or provided to allies.

For instance, the rapid expansion of Islamic State was raising the importance of border protection for some Middle Eastern countries, he said.

Ground vehicle sales, which slumped after the end of the war in Iraq, could also nose up given the resurgence of a more aggressive Russia, defense consultant Loren Thompson said.

General Dynamics just signed a 3.5 billion-pound deal with Britain's army for Scout specialist tanks, and other orders could follow, Thompson told the Reuters summit.

*Editing by Ros Krasny and Jonathan Oatis*

# U.S. exporters wary of short-term Ex-Im extension

BY AMANDA BECKER AND KRISTA HUGHES  
WASHINGTON, SEPTEMBER 10, 2014

**U**.S. businesses that rely on the Export-Import Bank for financing are uneasy about a Republican plan for a nine-month extension of the bank's charter, fearing uncertainty about the lender's future could put them at a disadvantage against overseas competitors.

Export-Import Bank President Fred Hochberg told the Reuters Aerospace and Defense Summit on Wednesday that, although he did not want to pre-judge the decision by lawmakers, the norm had been five-year extensions.

"The most important thing business people are looking for is some certainty so they can make their business plans," he said.

"It's very hard to decide about investing in new equipment, embarking on a sales campaign overseas, a few weeks at a time or a few months at a time."

Hochberg has pushed back against criticism from conservative lawmakers who would like to close the bank, and has waged an information campaign to spread the word about how Ex-Im helps U.S. businesses.

The leaders of some companies that receive credit from the bank were in Washington this week to urge a long-term reauthorization of Ex-Im's charter.

Applied Machinery, a Texas-based manufacturer of land-based drilling rigs, relies on Ex-Im guarantees to get private-sector lenders on board for projects in places such as Nigeria, Tunisia and Egypt, Chief Executive Officer James McDevitt said.

"We've asked the banks so far, 'What is the game plan if Ex-Im goes away?' They have no answer for us," McDevitt said at a briefing at the National Association of



Chairman and President of the Export-Import Bank Fred Hochberg talks during the second day of the Reuters Aerospace and Defense Summit in Washington, September 10, 2014.

REUTERS/LARRY DOWNING

Manufacturers.

Republican leaders in the House of Representatives proposed a plan on Tuesday to keep Ex-Im operating through June 2015, well past the current Sept. 30 expiration date.

Ex-Im, whose charter was once routinely re-authorized by Congress, has faced the biggest threat to its survival in its 80-year history this year when fierce opposition to it emerged from Tea Party-backed House Republicans.

The bank's foes say it promotes crony capitalism and favors big businesses over smaller companies. Its supporters, who include President Barack Obama and many Democrats, say it spurs job creation by pro-

moting sales of U.S. goods abroad.

Ex-Im underwrites loans and insures exports for U.S. companies and lends to foreign entities that buy U.S. goods, ranging from Boeing Co (BA.N) airliners to pickles to oil-drilling equipment.

## WARY CUSTOMERS, ADJUSTED PLANS

As the Sept. 30 deadline approaches, exporters say they are fielding questions from wary overseas customers.

David Howell, senior vice president at Westinghouse, which provides nuclear power plant products to foreign utility companies, told Reuters he has been trying to reassure customers.

"Certainly short-term is better than nothing," Howell said. "But it doesn't solve the problem and in many ways gives our competition the ammunition to plant the seeds of doubt in utilities' minds."

Other businesses have already shifted plans to mitigate Ex-Im uncertainty.

Insurance broker Kathy Edwards of Global Business Solutions said she has started telling larger clients to pursue private-sector financing. But many of her smaller clients do not have that option, she added, given that insurance premiums from private-lenders start at \$10,000 and can be obtained from Ex-Im for a fraction of that cost.

"A short-term reprieve just means we will have to go through all of this again in several months. It's not a solution," Edwards said.

McDevitt said Applied Machinery has already delayed finalizing major deals.

"We kind of backed off on some of these big deals we were pushing earlier because we are uncertain that, if we were to win one



of these big deals, how would we finance it?" he said.

Gary Mendell of Meridian Finance Group said late on Tuesday that, in practical terms, there was little difference in extending Ex-Im's charter through June 2015 as opposed to late 2014, as some lawmakers initially suggested.

"It still keeps this question open about the long-term longevity of the Ex-Im Bank," Mendell said in an interview.

### REPUBLICAN DEAL

Conservative opposition to Ex-Im has been led by House Financial Services Chairman Jeb Hensarling of Texas and House Majority Leader Kevin McCarthy of California.

Hensarling said Wednesday he would support a deal announced by House Speaker John Boehner to reauthorize Ex-Im as part of a package to fund the government through mid-December, but future decisions about the bank should be considered separately.

"It should stand or fall on its own," Hensarling said at a Hillsdale College event in Washington.

Representative Denny Heck, a Democrat who has Boeing jobs in his Washington state district, said the short-term extension would give bank opponents exactly what they sought.

"They know that this will put a huge question mark over the future of the bank," Heck said.

*Editing by Andre Grenon*

## Aerospace industry decries lack of graduates, diversity

BY VICTORIA M. WALKER

WASHINGTON, SEPTEMBER 11, 2014

**T**here is an urgent need to attract home-grown and more diverse engineering talent to the U.S. aerospace and defense industry, the head of the sector's main trade association said on Thursday.

"We do not have a robust pipeline of young people with the right skills and training coming into the workforce," said Aerospace Industries Association Chief Executive Officer Marion Blakey.

The science, technology, engineering and mathematics disciplines "are still really less than what we need in terms of young people, both in junior high and high school as well as in college," Blakey told the Reuters Aerospace and Defense Summit.

Blakey said the shortage of young recruits resulted from a combination of factors, including the industry doing a poor job of portraying the field in a positive light to young candidates coming out of college.

The association has warned of a rush of impending retirements coupled with a shortage of trained technical graduates. While many industries can outsource engineering work or recruit foreign graduates, most design work on U.S. military systems must be done by U.S. citizens.

Architectural and engineering services added over 3,000 jobs in August, according to the U.S. Bureau of Labor Statistics, which tracks job growth.

The industry could also do a better job of hiring and retaining women and minorities, Blakey said at the summit, held at the Reuters Washington bureau.

"We're very concerned about diversity in the industry. We do not have both enough



Marion Blakey, president and CEO of Aerospace Industries Association, gestures during the last day of the Reuters Aerospace and Defense Summit in Washington, September 11, 2014.

REUTERS/LARRY DOWNING

women (and) people of color coming in. And when we do, we tend to lose them at a greater rate," she said.

"But we're trying to address those things with specific programs," she added without elaboration.

Blakey's comments came days after U.S. Navy Secretary Ray Mabus told the summit that he planned to take action to boost the numbers of women serving in the Navy and Marine Corps, which currently stand at 18 percent and 8 percent respectively.

*Editing by Ros Krasny and Lisa Shumaker*

# Pratt sees clarity on 'root cause' of F-35 engine issue by end Sept



The fourth U.S. Air Force F-35A Lightning II aircraft arrives at the 422nd Test and Evaluation Squadron at Nellis Air Force Base, Nevada in this April 24, 2013 photo released on May 8, 2013. **DANIEL HUGHES/U.S. AIR FORCE/HANDOUT VIA REUTERS**

BY ANDREA SHALAL  
WASHINGTON, SEPTEMBER 10, 2014

**U**nited Technologies Corp's (UTX.N) Pratt & Whitney unit said the "root cause" of the June 23 engine failure on a Lockheed Martin Corp (LMT.N) F-35 fighter jet should be clear by the end of September, which would pave the way for over \$1 billion in contracts for another 84 engines.

Engine maker Pratt & Whitney said it has delivered six of its F135 engines to the U.S. government since Aug. 29, when it resumed deliveries that had been halted after the June incident which grounded the F-35 fleet for weeks and prevented its international debut.

Bennett Croswell, president of Pratt & Whitney Military Engines, said he still hoped to keep the government's flight test plan on track through a series of measures aimed at addressing the issue and lifting re-

strictions on test aircraft.

"I believe that through the combination of things we will keep the flight test program on track," Croswell told the Reuters Aerospace and Defense Summit.

Separately at the Reuters summit, officials from the military and Lockheed echoed the timeline for identifying the cause of the engine incident.

"We're reasonably confident we're looking at the right thing, and then we're reasonably confident it's going to prove out in the next couple of weeks," Rear Admiral Randy Mahr, deputy director of the F-35 program, told the summit.

In June, an Air Force F-35A training jet caught fire after its Pratt engine broke apart and ripped a fuel line as the jet prepared to take off from Eglin Air Force Base in Florida. U.S. officials blame the incident on excessive rubbing of part of the engine's fan section against an adjacent seal.

The incident has raised fresh concerns

about the \$400 billion F-35 Joint Strike Fighter program, the Pentagon's largest-ever arms program, which is about 70 percent over initial cost estimates and years behind schedule.

U.S. officials say the program is back on track after earlier problems, although Air Force Lieutenant General Chris Bogdan last week said the engine issue had put the development program about 30 to 45 days behind schedule.

Croswell said Pratt was taking the issue very seriously and expected it to be resolved "in relatively short order." He also noted that such problems were meant to be found during the design and development phase of any new program.

The fix should be moderate in cost, Croswell said.

"It should not be a very expensive solution," he said, noting that retrofits would be possible without an expensive tear-apart of the F-35's powerful engine.



Croswell said Pratt had essentially wrapped up negotiations with the Pentagon on the 84 engines in the seventh and eighth low rate production contracts, but Bogdan wanted a clearer understanding of the root cause of the incident before signing off on an agreement valued at over \$1 billion.

The Pentagon is negotiating a separate contract with Lockheed for an eighth batch of jets.

Croswell confirmed that Pratt would pay to fix the current issue and said the company had also agreed to share in the cost of future problems, but details were still being finalized.

"We have agreed in principle to provide a warranty to the U.S. government for future LRIP contracts. We have not yet finalized a warranty agreement, but P&W would likely pay a percentage of the total cost of certain performance specification shortfalls," spokesman Matthew Bates said.

Croswell said the engine failure came about eight hours after an unusual maneuver involving a roll, yaw and heavy gravity loads during sharp turns. "This is a maneuver that the engine should be able to withstand," he said.

Croswell said Pratt had already completed a baseline test of the current engine at its West Palm Beach, Florida facility, and had begun testing possible fixes. He said the company was investigating whether the density of the polyimide, a rubbery material made by Dupont (DD.N), had played a role. That material is applied to a stator vane made by Cobham Plc (COB.L), which helps direct the air flow in the engine.

The component that broke apart ties the fan blade assembly together. Pratt said that part is made by two separate companies but declined to identify them.

*Official correction to final two paragraphs to clarify which component made by Cobham Plc*

*Additional reporting by Lewis Krauskopf;  
Editing by Leslie Adler*

# Carrier drone should be able to do more than spy: U.S. Navy

BY ANDREA SHALAL  
WASHINGTON WED SEP 10, 2014

**T**he U.S. Navy's planned unmanned plane for use on aircraft carriers should eventually be able to take on additional roles besides just surveillance, Navy Secretary Ray Mabus said on Wednesday.

The Navy last week said it had delayed this month's planned kickoff of a competition for the new carrier-based unmanned spy plane, citing affordability concerns and a Pentagon-wide review of intelligence and surveillance programs.

Mabus addressed the Unmanned Carrier Launched Airborne Surveillance Strike (UCLASS) program during the Reuters Aerospace and Defense Summit, but stopped short of calling the delay a setback for the program.

"It's going through a process at (the Office of the Secretary of Defense) to take a broader look at programs," he said, adding that decisions about the program's future would likely be included in the Pentagon's fiscal 2016 budget request.

Companies interested in the competition include Northrop Grumman Corp (NOC.N), maker of the X-47B unmanned, unarmed plane that has already been tested on U.S. carriers, Boeing Co (BA.N), Lockheed Martin Corp (LMT.N), and privately held General Atomics, which builds the popular Predator unmanned planes used by the U.S. Air Force and other government agencies.

Congress has been debating what the range and armaments should be for the

Navy's next-generation unmanned plane.

Mabus said the Navy had demonstrated that an unmanned plane could take off from and land on a carrier, and that it could be maneuvered on the deck and integrated into an air wing. The challenge, he said, was ensuring that the platform could be adapted for more than one single mission.

"Like all Navy programs, you want it to be able to grow," he said. "You want it to have the capacity to not just be an (intelligence, surveillance and reconnaissance) platform, but to also be a refueling platform, to be a strike platform in permissive environments, and you want it to be a bridge to unmanned strike in a contested environment."

Loren Thompson, chief operating officer of the Virginia-based Lexington Institute, told the summit the UCLASS aircraft was seen as "the program that's never going to happen," given competing budget priorities and debate over the plane's needed capabilities.

He said potential bidders were jockeying behind the scenes to shape the plane's requirements in ways that would favor their respective offerings. "Anytime there's a new start, everybody is angling for the most advantage," he said.

*Editing by Ken Wills*

# U.S. defense industry says global turmoil swaying budget hawks

BY DAVID ALEXANDER AND ANDREA SHALAL  
WASHINGTON SEPTEMBER 12, 2014

Images of two Americans being beheaded and of Russian tanks rolling through Ukraine have boosted pressure on Congress to roll back \$1 trillion in mandatory defense cuts that the defense industry blames for almost 100,000 job cuts in recent years.

U.S. lawmakers this week signaled support for President Barack Obama's plan to take action against Islamic State extremists in Syria and Iraq.

For now, the Pentagon is working on the assumption that the fiscal 2016 budget will include deep spending cuts that were partially offset in 2014 and 2015, and further reductions in personnel.

But executives from Lockheed Martin (LMT.N) and Boeing (BA.N), government officials and industry analysts told the Reuters Aerospace and Defense Summit this week that more lawmakers now recognize that current global crises meant a different approach was needed - in part because of relentless lobbying by the industry.

Military leaders have warned that lower troop numbers pose a bigger security risk and could even force the abandonment of elements of Obama's defense strategy.

"The more peaceful world that the Obama administration anticipated when their second term began has disappeared," said Loren Thompson, analyst with the Lexington Institute think tank.

"It's one thing to cut technology when you're fighting enemies that have no planes and no tanks," Thompson told the Reuters summit in Washington. "It's quite another when your concerns have been refocused on countries like Russia and China (which



COO of Lexington Institute Loren Thompson speaks during the second day of the Reuters Aerospace and Defense Summit in Washington, September 10, 2014. **REUTERS/LARRY DOWNING**

are rapidly expanding their investment in nuclear and conventional weapons, not to mention cyber."

The Lockheed and Boeing executives, as well as government officials and industry analysts, told the Reuters Summit that resumption of the cuts would mean new business risks to major defense companies and the hundreds of firms in their supply chains.

Marion Blakey, chief executive of the Aerospace Industries Association, the industry's largest trade group, said budget reductions and uncertainty about future funding resulted in a loss of 97,000 jobs from the U.S. defense industry between

2010 and 2013, or 11 percent. Cuts hit smaller companies particularly hard, she said.

But fiscal conservatives in Congress - the Tea Party wing that led the drive to sequestration - have started to realize that spending on defense, and on weapons systems in particular, has been cut too much, Blakey said.

"There was a lot of wishful thinking in 2010 that we could drive the budget down and still maintain a strong defense, and that's just proven to be untrue," she said. "Many of those members are going to have to make some tougher choices."

Dennis Muilenburg, Boeing's chief operating officer, said lower military spending had forced Boeing to cut about 15,000 workers in its defense and space division over three years, with more to come. The cuts were part of a drive to lower overhead by \$4 billion, with another \$2 billion still to come, he said.

Analyst Richard Aboulafia with the Virginia-based Teal Group said the tide was shifting away from the deficit hawks clamoring for unending military spending cuts.

"Current events are strong enough to remind people that the defense budget can't just go back to where it was in the 1990s. Even the Tea Party is starting to lose traction with its 'deficit first' message," he said.

Orlando Carvalho, executive vice president of Lockheed's aeronautics division, said his company continued to push for the repeal of the mandatory budget cuts, and hoped that U.S. lawmakers would find a way to do so.

*Editing by Ros Krasny and Leslie Adler*





US Naval Service woman stand near fighter planes onboard the USS Theodore Roosevelt, a naval aircraft carrier which docked in Table Bay, Cape Town on a good will visit to the South African waters, October 6, 2008. **REUTERS/MARK WESSELS**

## U.S. Navy, Marines need more women: Navy secretary

BY LEWIS KRAUSKOPF AND ANDREA SHALAL  
WASHINGTON, SEPTEMBER 10, 2014

**U**.S. Navy Secretary Ray Mabus said more women should be serving in the Navy and Marine Corps, and plans to take action to boost their presence in those military branches.

"We don't have enough women in either the Navy or the Marine Corps," Mabus told the Reuters Aerospace and Defense Summit on Wednesday as he kicked off a

drive to expand the number of women in the Navy.

Women represent 18 percent of the Navy and 8 percent of the Marine Corps, Mabus said.

"I don't know exactly what the goal ought to be, but I know those are too low," he said.

About 200,000 women serve in the entire active duty military, or about 15 percent of that force, according to Navy Lieutenant Commander Nate Christensen. More than

280,000 women have deployed in support of operations in Iraq and Afghanistan in the past decade, Christensen said.

The military services have until January 2016 to assess which jobs are open to women after a January 2013 decision by then Defense Secretary Leon Panetta to allow women to serve in combat, Christensen said.

About 80,000 of an estimated 250,000 additional jobs have already been opened to women as result of those reviews.

U.S. Navy Secretary Ray Mabus speaks at the second day of the Reuters Aerospace and Defense Summit in Washington, September 10, 2014. **REUTERS/LARRY DOWNING**



Indeed, some of the Pentagon's biggest programs also have fewer women than the average across the force.

Women account for 12 percent of the Pentagon's F-35 Joint Program office, but some hold very senior jobs, said spokesman Joe DellaVedova. For instance, the civilian deputy program director, Steffanie Easter, has the civilian rank equivalent to the three-star general who runs the program.

Mabus, a former Mississippi governor who has served as Navy secretary since 2009, cited the importance of a diverse force as the reason for bringing more women to the service.

"The more diverse input you have into something, the better the organization is," Mabus said.

The Navy is developing measures it can take on its own and some that would need congressional approval, Mabus said.

For example, Mabus pointed to a pilot

program that allows service members to take up to three years off without any harm to their careers, and said it might boost the retention of women.

He said the Navy would ask Congress to make the program permanent since people still fear it could be withdrawn.

"We're looking at how ... we can retain people past 4 years or 8 years, how we can be more flexible in terms of how we manage people," Mabus said. "So that if you need to take time off, that your career will not be harmed."

Vice Admiral Bill Moran, chief of naval personnel, recently said the Navy was re-evaluating its recruiting, training and career management programs, including possible changes to make the current promotion system more flexible.

Mabus said the Navy was also looking more skeptically at uniforms that distinguish men from women.

"We're not moving to put women in men's uniforms. We're moving to the term 'uniform,'" he said. "We don't want to segregate women or anybody else in any way in the military."

Mabus has made promoting diversity a hallmark of his tenure as secretary, which included the 2011 christening of a Navy re-supply ship after civil rights leader Medgar Evers.

He also cited the establishment of Navy Reserve Officer Training Corps programs at Arizona State University and Rutgers University in New Jersey, which he described as "two of the most diverse campuses in our country."

"The force that protects a democracy should reflect the population that it protects much more than we do today," he added.

*Editing by Andre Grenon*



# Lockheed, Pentagon say near deal on next batch of F-35s

BY ANDREA SHALAL

WASHINGTON, SEPTEMBER 9, 2014

**L**ockheed Martin Corp (LMTN) is in the final stages of negotiations with the Pentagon about an eighth batch of F-35 fighter jets, with an agreement weeks or perhaps only days away, a company executive and a senior military officer said Tuesday.

The deal, valued by analysts at over \$4 billion, will cover 43 of the most advanced U.S. warplanes. Lockheed is building three models of the Joint Strike Fighter, or Lightning II, for the U.S. military and nearly a dozen foreign countries.

The Defense Department expects to spend nearly \$400 billion to develop the radar-evading plane and buy 2,457 jets in coming decades. It is the largest U.S. and global weapons program.

Pratt & Whitney, a unit of United Technologies Corp (UTX.N), is also close to a deal worth over \$1 billion for 84 engines, but that will be cleared only after Pratt and the government determine the cause of an engine failure that grounded the F-35 fleet for weeks this summer.

Industry and Pentagon officials said the engine issue was being addressed and should not affect the Marine Corps' plan to start using the jets in combat starting next July.

Orlando Carvalho, executive vice president of Lockheed's aeronautics division, told the Reuters Aerospace and Defense Summit the company was in touch daily with the Defense Department about a few remaining issues in the contract talks.

"We are in the endgame of the negotiation," he said. "Our hope is that we'll close shortly. I'll say weeks ... maybe if we're a



Executive Vice President of Lockheed Aeronautics Orlando Carvalho speaks during the Reuters Aerospace and Defense Summit in Washington, September 9, 2014. **REUTERS/LARRY DOWNING**

little bit lucky, days."

Pentagon officials originally hoped to conclude the current round of contract negotiations with Lockheed and Pratt by late May or June, but the talks were delayed after an engine failure and fire on an F-35 A-model jet at a Florida air base in June.

Rear Admiral Randy Mahr, F-35 deputy program director, told the summit at Reuters' Washington bureau that a deal with Lockheed could be finalized in coming days or weeks, followed by a Pratt deal once the engine issue had been resolved.

Mahr said the Pentagon had also decided to negotiate the next two production contracts with Lockheed at the same time to ensure higher order quantities and better pricing.

He said those contracts would still be

awarded to the company one year at a time given the U.S. budget process and tight restrictions on multi-year contracts.

Carvalho said the ninth and 10th batches of the F-35 were expected to include 154 aircraft, which would help provide stability to the company's suppliers. He said Lockheed hoped to segue into true multi-year agreements that contained more assurances once the plane reaches full production in 2018.

Lockheed and the Pentagon negotiated a deal for the sixth and seventh batches of jets at the same time several years ago, and Pratt & Whitney is now in talks about two years' worth of engines.

Lockheed shares rose more than 0.50 percent after Carvalho's comments, but eased to close up just 17 cents, or 0.10 per-

cent, at \$174.90 on the New York Stock Exchange.

Mahr said the overall F-35 program was doing “pretty well” but said he continued to worry about the pace of retrofitting existing jets to fix problems discovered during flight testing.

He said the Pentagon is also trying to increase how often the new jets are available for operational use. The goal was to boost the “availability rate” to 57 percent by the end of the year, up from rates of around 30 percent to 40 percent now.

Mahr said current rates were low because some components were not lasting as long as expected. The rates also include jets that are out for repairs and those whose engines must be inspected every three hours after the June engine failure.

Carvalho said top executives from Lockheed, Pratt & Whitney, Britain’s BAE Systems (BAES.L) and Northrop Grumman Corp (NOC.N) were also in talks about driving down the cost of operating and maintaining the jets, which the Pentagon has estimated will reach over \$1 trillion over the next five decades.

Mahr said the Pentagon was considering one proposal for trimming operating costs that was modeled on a “Blueprint for Affordability” announced in July under which Lockheed and other key suppliers will invest \$170 million to drive down production costs, but can recoup the money if the measures work out.

*Additional reporting by Victoria Walker;  
Editing by Ros Krasny and Jonathan Oatis*

## Lockheed says ‘very happy’ teamed with Boeing for bomber bid

BY ANDREA SHALAL  
WASHINGTON, SEPTEMBER 9, 2014

**T**he Pentagon’s biggest supplier, Lockheed Martin Corp (LMT.N), on Tuesday said it was “very happy” it had teamed up with Boeing Co (BA.N) to bid for the U.S. Air Force’s new long-range strike bomber and expected the companies to submit a joint bid soon.

“We’re very pleased with how our team has come together, and how that enabled the solution that we’re going to be offering,” Orlando Carvalho, executive vice president of Lockheed’s aeronautics division, told the Reuters Aerospace and Defense Summit.

Carvalho declined to provide any specifics about the joint offering, or the timetable for bids, saying only that the team would submit a bid to the Air Force soon.

The Air Force has been unusually tight-lipped about the bomber program, saying only that it plans to buy as many as 100 new bombers for no more than \$550 million each. U.S. arms makers have been working on classified contracts preparing for the new program for several years, but few details have emerged.

The Air Force announced on July 10 that it had released a formal request for proposals for the bomber and planned to select a winner in the spring of 2015. It provided no details, and declined even to say when the bids were due.

Boeing, the Pentagon’s No. 2 supplier, and Lockheed first announced last October that they would join forces to bid for the multi-billion-dollar project, which U.S. Air Force officials say is a top acquisition priority.

Boeing, which has played a role in every U.S. bomber program since World War Two, will be the prime contractor, with Lockheed as its primary subcontractor, the companies said. The two firms initially teamed up for the competition in 2008, but parted ways two years later when the program was put on hold.

Northrop Grumman Corp (NOC.N), maker of the B-2 stealth bomber, also plans to compete to build the new bomber.

Jerry DeMuro, chief executive officer of the U.S. unit of Britain’s BAE Systems Plc (BAES.L), told the summit that his company was a leading provider of electronic warfare equipment for a range of programs, but he declined to give any details about BAE’s role on either team’s bid.

“BAE Systems has more than 50 years of experience designing and fielding the nation’s most advanced electronic technologies for aircraft, with a vast array of electronics supporting all aspects of military aircraft missions,” said BAE spokesman Brian Roehrkasse.

“The company is well positioned to support many of the U.S. Air Force’s future priorities. However, due to the sensitive nature of the long-range strike bomber program, BAE Systems is unable to discuss whether it is pursuing opportunities to support the program,” he said.

*Editing by Lisa Shumaker*



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An employee is pictured while working during a tour of the Boeing 737 assembly plant in Renton, Washington February 4, 2014. **REUTERS/DAVID RYDER**

## Boeing, Airbus seriously studying speeding factories

BY ALWYN SCOTT AND TIM HEPHER  
WASHINGTON, SEPTEMBER 11, 2014

**B**oeing Co (BA.N) and European rival Airbus (AIR.PA) said on Thursday they are both considering seriously whether to make their best-selling narrow-body jetliners at faster rates, news that may cheer investors in the short term but could raise longer-term market concerns.

Airbus is studying whether to increase production of its best-selling A320-family aircraft beyond the record level of 46 jets a month already targeted for 2016, and a decision could come by year-end, Airbus Americas President Barry Eccleston told

the Reuters Aerospace and Defense Summit in Washington.

"If we're going to make that decision, we would want to make that decision as soon as possible, because the market's already there," Eccleston said. (Video: [reut.rs/1tDdrmj](http://reut.rs/1tDdrmj))

Separately, Boeing has seriously considered increasing production of its 737 narrow-body airplanes to more than 47 a month, President and Chief Operating Officer Dennis Muilenburg said in a separate interview at the summit. Boeing's current 737 output is a record 42 a month and it already has plans to lift the rate to 47 a month in 2017.

"We now see continuing pressure to further increase that," Muilenburg said in a television interview at the Reuters summit. "We've taken a very serious look at options, both timing and volume, but clearly pressure is in an upward direction." (Video: [reut.rs/1rYpMWb](http://reut.rs/1rYpMWb))

Industry experts expect Boeing's next target would be 52 a month, and Muilenburg's comments suggest the analysis may be largely complete, and that the results may be known shortly.

In August, Boeing's chief financial officer, Greg Smith, signaled the company was close to deciding whether to push 737 production to 52 a month. On Monday, the

chief executive officer of Boeing Commercial Airplanes, Ray Conner, said the plane maker was feeling “incredible pressure to go higher in rate.”

The upward push in production is being driven by scorching demand from airlines for new, fuel-efficient versions of the planes.

Airbus and Boeing have years of production backlog on their order books, so customers ordering planes now must wait years to get them. Raising output allows more near-term plane deliveries.

But for both companies, the ability to increase rates depends on whether suppliers can keep up and support higher production levels and pose a quandary for investors.

While delivering more planes rings the cash register at Airbus, Boeing and their suppliers, it also can raise costs and chip away at profit margins. Specialized models also can do that, such as a 200-seat version of the 737 MAX that Boeing launched with Ryanair (RYA.I) on Monday.

“You’re building a new plane for Ryanair. There’s no way this doesn’t dilute margins,” said Richard Aboulafia, an aerospace analyst at the Teal Group in Fairfax, Virginia.

Churning out 50 or 60 jets a month could cut profit margins a percentage point on those planes, he said, because costs could rise at such high production levels. “You’re not exactly reaching for the stratosphere in terms of profitability.”

He noted: “If you push it to 60 and keep it there too long...you’re going to have engineered a bust cycle.”

Eccleston also said that Airbus is close to finding a buyer for six Rolls-Royce powered A380s superjumbos that had been earmarked for Skymark Airlines Inc (9204.T) of Japan.

Airbus recently cancelled the order because of the airline’s inability to make the required advance payments. Eccleston declined to elaborate on who the buyer might be.

*Editing by Leslie Adler and Ken Wills*

## U.S. says would back alternative to French warship sale

BY TIM HEPHER

WASHINGTON, SEPTEMBER 10, 2014

**T**he United States on Wednesday threw its weight behind efforts to ensure that the sale of two French warships to Russia, the first of which has been delayed due to international concerns about the Ukraine crisis, is called off permanently.

France, facing pressure from Washington and other allies to halt the sale, said on the eve of a NATO summit last week that it would not deliver the first of two Mistral-class helicopter carriers for now because of Moscow’s actions in eastern Ukraine.

Speaking at the Reuters Aerospace and Defense Summit in Washington, U.S. Navy Secretary Ray Mabus welcomed the decision.

Asked about suggestions by U.S. and European lawmakers that NATO should buy the ships as a permanent alternative to the sale, Mabus said, “We had made our concerns very well known about giving Russia this capability, and I think you ought to explore any way you can to keep these two amphibious ships out of Russian hands because it will give them capabilities that they don’t have today.”

The ships are being made at the French state DCNS shipyard, in which French defense company Thales SA (TCFPPA) has a minority stake.

Gregory Kausner, deputy assistant secretary of state for regional security and security assistance, said it was not clear if France had canceled the sale or delayed it, and Washington was watching the situa-

tion “with a very careful eye.”

“We’ve been clear that the provision of that type of defense equipment to Russia right now in the context of the current environment is not necessarily congruous with where NATO is,” Kausner said. He said countries could take a “measured approach to their relationships” if the current ceasefire prevailed.

In late May, a group of U.S. politicians wrote to NATO Secretary-General Anders Fogh Rasmussen, suggesting that France cancel the sale and that NATO buy or lease the vessels instead, according to a copy of the letter obtained by Reuters.

There have also been tentative suggestions that the European Union should buy the ships, according to defense sources.

Hollande told reporters on the sidelines of last week’s summit in Wales that the contract to supply the ships was neither canceled nor suspended, but that the conditions for delivering the first ship – due in October – were not ripe.

“What are the conditions? A ceasefire and a political settlement,” he said. “Today these conditions are not in place.”

If there were further complications, delivery would be delayed but the contract would not be suspended, he added.

Russia’s industry minister has said Moscow still expects France to provide it with the two warships and has accused Paris of bowing to U.S. pressure by suspending delivery of the first one.

*Editing by Jonathan Oatis and Ken Wills*

# U.S. Ex-Im bank would back Airbus sales: Hochberg

BY ALWYN SCOTT AND TIM HEPHER  
WASHINGTON, SEPTEMBER 10, 2014

**T**he U.S. Export-Import Bank would provide financing for exports of Airbus Group (AIR.PA) jetliners, provided they were assembled in the United States with sufficient content from domestic suppliers, the bank's head said on Wednesday.

"We're about U.S. jobs," Ex-Im Bank President Fred Hochberg told the Reuters Aerospace and Defense Summit in Washington.

"We have no national treasures," Hochberg said, in a reference to Airbus arch rival Boeing Co (BA.N). "Every company is a national treasure."

The bank, which supports loans for U.S. manufacturers selling products to foreign companies, is at the center of a bruising battle over whether Congress should renew its authority to operate, which expires on Sept. 30.

About 46 percent of the bank's total financial exposure is for jetliners made by Boeing, according to U.S. Government Accountability Office figures.

Airbus is setting up a factory in Mobile, Alabama, to make commercial jets, and is due to begin making deliveries in 2016.

While Airbus intends to sell the aircraft to U.S. airlines, there would be no restriction against U.S. export credit support for foreign airlines buying U.S.-manufactured Airbus planes, Hochberg said.

"To the extent that the Airbus plane is actually made here, we could support those exports that are made in the United States," he said.

Airbus has said the U.S. supplies more than 40 percent of its aircraft-related pur-



Chairman and President of the Export-Import Bank Fred Hochberg gestures during the second day of the Reuters Aerospace and Defense Summit in Washington, September 10, 2014.

REUTERS/LARRY DOWNING

chasing, including engines.

Hochberg said there were no minimum content requirements, but that the Ex-Im bank looks closely at content and labor in product before deciding on support.

He said export-credit agencies in other countries were often surprised to learn the Ex-Im bank will support foreign companies manufacturing in the United States, and does not pick companies to support as "champions."

For example, the bank supplies export financing for the customers of a Siemens AG (SIEGn.DE) gas-turbine factory in North Carolina that competes with General Electric Co (GE.N).

"We treat Siemens and GE as one and

the same," he said. "We have no preference for one over the other. Siemens employs people in America (and) to the extent that the product is made here we support it."

Boeing is among those lobbying to have the bank's charter renewed, saying it essential to support U.S. jobs. Other groups, including Delta Air Lines Inc (DAL.N) and the Air Line Pilots Association, say the U.S. Ex-Im bank should reform its policies and stop offering low-cost credit to wealthy foreign airlines buying widebody Boeing aircraft since they compete with U.S. carriers on international routes, affecting jobs.

In the Reuters interview, Hochberg dismissed such a compromise, saying the bank was at par with what others were doing and eliminating it would tilt the balance against U.S. exporters, threatening 205,000 jobs.

He noted that reliance on U.S. Ex-Im credit has declined this year as financial markets improved, in part because foreign airlines have access to other types of lending. Ex-Im loans to mining and oil-and-gas companies also have dropped, he said.

Foreign airlines have increasingly used bonds known in the U.S. as enhanced equipment trust certificates (EETCs) to finance jet purchases. EETCs, which offer lower interest rates than the Ex-Im bank now provides, give lenders the right to seize aircraft quickly if a carrier goes bankrupt.

The EETC market is a bigger factor in lowering borrowing costs for foreign airlines than the Ex-Im Bank, Hochberg said.

Also, "airlines are better able to tap into conventional bank lending than they were a year or two years ago," he added.

*Editing by Jonathan Oatis and Andre Grenon*



# Boeing unconcerned by Ex-Im's potential support for Airbus

BY ALWYN SCOTT AND JEFFREY DASTIN  
WASHINGTON, SEPTEMBER 11, 2014

A top Boeing Co (BA.N) executive on Thursday showed no concern that rival Airbus (AIR.PA) could receive U.S. Export-Import Bank financing for its U.S.-manufactured jetliners if it met qualifications.

Boeing President and Chief Operating Officer Dennis Muilenburg rebutted the European planemaker's view that U.S. export finance is more favorable than what European credit agencies offer.

The Ex-Im Bank "is something that's for all industry," he said at the Reuters Aerospace and Defense Summit.

The Ex-Im Bank provides loans or loan guarantees for any export largely manufactured in the United States, worth up to 85 percent of its value. On Wednesday, Ex-Im Bank Chairman Fred Hochberg told Reuters that the bank would support foreign sales of U.S.-manufactured Airbus jets if they qualified with sufficient domestic content.

Muilenburg said on Thursday that Boeing fully supports the domestic content rules. "We live by them, and we are more than willing to compete on a fair and level playing field."

Airbus is building a production complex in Mobile, Alabama, that is due to begin delivering planes in 2016.

The jets are not intended for foreign sale, so Airbus doesn't plan to seek U.S. Ex-Im Bank support, Airbus Americas President and Chief Executive Officer Barry Eccleston told Reuters.

"Although we welcome what Chairman Hochberg said, and it kind of confirms what we had assumed, we're not expecting in practice (to receive Ex-Im financing,)"



Airbus Americas President Barry Eccleston listens to a question on the last day of the Reuters Aerospace and Defense Summit in Washington, September 11, 2014. **REUTERS/LARRY DOWNING**

Eccleston said.

Congress is debating whether to reauthorize the U.S. Ex-Im Bank's charter. Boeing and others argue that the U.S. institution is crucial to their ability to compete with other nations that back their exporters. Delta Air Lines (DAL.N) and others have argued that U.S. Ex-Im Bank financing should not be offered to wealthy foreign carriers, since it places U.S. airlines at a competitive disadvantage.

Eccleston also said the U.S. Ex-Im Bank more actively supports Boeing than European export credit agencies support Airbus.

"We are very happy with what (European credit agencies) do for us, (but) we find that Ex-Im generally is more creative with the terms and conditions that they offer," he said.

But Boeing's Muilenburg said inter-

national export lending rules ensure that the credit is essentially the same in various countries.

Many companies can currently find market-rate financing that is cheaper than export-credit loans or loan guarantees. But even so, failure by Congress to reauthorize the U.S. Ex-Im Bank would put U.S. exporters at a disadvantage by removing that financing as a last resort if markets worsen, Muilenburg said.

"If we have a customer who's evaluating options from both companies, and he can have the confidence of backstop financing from one and not the other - which is what would occur if Ex-Im is not reauthorized - then that unbalances the competition," Muilenburg said.

*Editing by Meredith Mazzilli and Ken Wills*



## U.S. Navy to brief Hagel on small warship options

The soon to be commissioned United States Navy littoral combat ship USS Coronado is shown docked at Naval Station North Island in Coronado, California April 3, 2014. **REUTERS/MIKE BLAKE**

BY ANDREA SHALAL  
WASHINGTON, SEPTEMBER 10, 2014

**T**he U.S. Navy is completing its recommendations after a detailed study of possible options for the Navy's next small warship, and plans to brief Defense Secretary Chuck Hagel soon, Navy Secretary Ray Mabus said on Wednesday.

The study, which was completed at the end of July, was "very rigorous, very detailed, very intense and looked very deep into all those different options," Mabus told the Reuters Aerospace and Defense Summit in Washington.

He declined to provide any details before the Navy submitted its findings and recommendations to Hagel and other senior Pentagon leaders.

The Navy created the task force earlier this year after Hagel expressed concerns about the survivability and firepower of the current Littoral Combat Ships (LCS) built by Lockheed Martin Corp (LMT.N) and Australia's Austal Ltd (ASB.AX).

Lockheed, Austal and others are anxious to see the findings of the task force and any Navy recommendations, which could affect funding for future warships.

Hagel ordered a pause in the LCS program after orders for 32 ships instead of proceeding with the 52 ships that had been planned and asked the Navy to study three options for the next 20 ships: sticking with the current LCS designs, modifying them, or switching to either a new design or another warship already in production elsewhere.

Mabus said the process now under way would help shape the Navy's fiscal 2016 budget request, which will take shape in coming months and should be submitted to Congress in February.

The Navy was due to brief U.S. lawmakers about the task force's findings this week, but the briefing was delayed while the Navy continued to examine the report and frame its own recommendations, according to a source familiar with the issue.

The LCS ships have suffered a series of technical problems, including engine issues,

but Mabus said the ships performed very well during recent deployments to Singapore and the Rim of the Pacific (RIMPAC) military exercise in Hawaii this summer.

The USS Independence, an aluminum trimaran design built by Austal, played an active role in the RIMPAC exercise, using its surface warfare equipment to "attack" four ships, operating two H-60 helicopters on its deck, and coordinating the anti-air assets around the USS Ronald Reagan aircraft carrier.

Mabus said the Navy had also nearly wrapped up testing of mine hunting and fighting weapons for the LCS ships, one of three systems being designed for interchangeable use on the ships.

The current LCS ships were built to hunt and fight mines, submarines and surface ships using those equipment packages, but officials have grown concerned that the ships also need some permanent weapons on board.

*Additional reporting by Victoria Walker;  
Editing by Jonathan Oatis and Andre Grenon*



# BAE Systems' U.S. unit focused on organic growth over M&A

BY JEFFREY DASTIN AND LEWIS KRAUSKOPF  
WASHINGTON, SEPTEMBER 10, 2014

Nearly two years after the merger of BAE Systems Plc (BAES.L) with rival EADS fell apart, BAE's U.S. unit on Tuesday said it is focused more on winning orders in key product lines than through mergers and acquisitions.

"We don't have a specific agenda to grow through M&A," Jerry DeMuro, chief executive officer of the U.S. unit of Europe's largest defense company, told the Reuters Aerospace and Defense Summit.

"If we see the right opportunities where we think we can create value, we will go ahead and do that and build on those," DeMuro said in his first media interview since becoming CEO in February.

DeMuro said BAE Systems is investing in five or six business areas - from ship-building and combat vehicles to naval guns and electronic warfare - to expand "organically."

The London-based manufacturer has seen revenues decline in recent years as the United States and Europe have scaled back military spending.

But DeMuro said BAE was continuing to invest in select business lines, including intercontinental ballistic missiles and its F-16 fighter upgrade business, to position it with the right products as it waits for an upturn in defense activity.

BAE is a key supplier of electronic warfare equipment for a range of programs, including Lockheed Martin Corp's (LMT.N) F-35 fighter, but DeMuro declined to comment specifically on any role the company may have in the industry teams competing to build the next generation of long-range bombers for the U.S. Air Force.



CEO of BAE Systems Inc. Jerry DeMuro speaks during the Reuters Aerospace and Defense Summit in Washington, September 9, 2014. **REUTERS/LARRY DOWNING**

"We will have a part, I am confident, in the electronic warfare, electronic defense suites," he said.

The commercial jetliner business offers "a dozen major opportunities" for BAE Systems over the next 15 months, including flight and cabin controls, as Boeing Co (BA.N) develops its 777X and 737 MAX jetliners due later this decade.

"We're making the investment to grow that business organically right now," he said, since "acquisitions are very expensive" in commercial aerospace at the moment.

DeMuro said BAE was also focused on ship repair and enhancement services for aging fleets since equipment is being used longer, rather than being replaced. The company is already the largest provider of maintenance and repairs for the U.S. Navy's non-nuclear surface fleet, he said.

BAE's focus on existing businesses comes nearly two years after French-German Airbus Group SA (AIR.PA), then

known as European Aeronautic Defense and Space Company, sought to merge with BAE Systems, adding commercial power to its defense business that only Boeing could have matched.

"EADS was an opportunity that presented itself, and I think the corporation had a fiduciary responsibility to explore those options," DeMuro said. "For other political reasons mostly European in nature, it fell through."

DeMuro said the merger would not have affected either company's U.S. business significantly.

Company shares on the London Stock Exchange rose about 0.42 percent Tuesday to close at 452.6 pence.

*Corrects to say BAE Systems is Europe's largest defense company in paragraph 2, corrects share price in paragraph 15*

*Editing by Alwyn Scott and Lisa Shumaker*



# Summit Speakers



**Richard Aboulafia**  
Vice President, Analysis  
Teal Group



**Fred Hochberg**  
Chairman and President  
Export-Import Bank



**Marion Blakey**  
President and CEO  
Aerospace Industries Association



**Gregory Kausner**  
Deputy Assistant Secretary of State  
for Regional Security and Security  
Assistance  
U.S. State Department



**Tom Captain**  
Vice Chairman, Principal, Aerospace &  
Defense Sector Leader  
Deloitte LLP



**Ray Mabus**  
Secretary of the Navy  
U.S. Navy



**Orlando Carvalho**  
Executive Vice President, Aeronautics  
Lockheed Martin



**Randolph Mahr**  
F-35 Deputy Program Executive Officer  
Rear Admiral  
F-35 Program office



**Bennett Croswell**  
President, Military Engines  
Pratt and Whitney



**Dennis Muilenburg**  
COO  
Boeing



**Jerry DeMuro**  
CEO  
BAE Systems Inc



**Ed Peartree**  
Director Defense Trade Controls Policy  
U.S. State Department



**Barry Eccleston**  
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