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[Back to previous page](#)

Defense contractors face realities of a slimmer Pentagon as cutbacks yield smaller awards

By Jonathan D. Salant, Published: February 18

Poet T.S. Eliot called April the cruelest month. Defense contractors would pick January.

The Pentagon's contract awards dropped 66 percent from December, to \$8.44 billion, the lowest level in at least 22 months, according to data compiled by Bloomberg. The previous low during that period was \$12.1 billion, in January 2013.

None of the biggest contracts announced last month — including those to General Electric and United Technologies — cracked \$1 billion. January's awards often lag because the Pentagon often pushes out more agreements in December, the end of its first quarter. The seasonal slump was exacerbated by defense budget reductions and a temporary spending bill that limited contracting last month.

"The elements have certainly come together," said Mark Amtower, partner at Amtower & Co., a government contracting consulting firm in Clarksville, Md.

Amtower said he expects another poor monthly performance when awards dip below \$8.4 billion this fiscal year.

"I don't see this trend going away anytime soon," he said.

The Defense Department announced 180 contracts with a maximum value of \$8.44 billion in January, compared with 295 agreements valued at as much as \$24.9 billion in December. Awards dropped 30 percent last month from a year earlier.

The Pentagon is required to announce contracts of at least \$6.5 million.

The temporary spending bill restricted new contracts and projects. Those limits ended after President Obama on Jan. 17 signed a \$1.1 trillion measure to fund the government through Sept. 30. That followed stopgap legislation enacted in October, which ended a 16-day partial government shutdown.

"The uncertainty of a government budget just paralyzed the agencies," said Robert Lohfeld, chief executive of Edgewater, Md.-based Lohfeld Consulting Group.

Bruce Tanner, chief financial officer of Lockheed Martin, told investors during a conference call on

the company's fourth-quarter results that he anticipated "a trough" in U.S. defense spending this year.

Raytheon's chief financial officer, Dave Wajsglas, said in a Jan. 30 interview that he didn't expect increased government business until the second half of 2014.

The trend, though, is going to be down, said Larry Allen, president of Allen Federal Business Partners, a consulting company based in McLean, Va.

"The budget is a good thing overall, but it doesn't mean there's a new day coming," Allen said. "We're still in an era where there's less money than there has been historically."

The defense spending cuts helped make 2013 the fourth consecutive year in which contract awards declined, the longest stretch since Ronald Reagan was president, according to data compiled by Bloomberg Industries analyst Brian Friel.

The agreement that ended the government shutdown also set spending levels through Sept. 30, 2015, partially mitigating the automatic federal spending cuts required under the process known as sequestration.

"I'm very encouraged that we got it pushed out for a couple of years," Marillyn Hewson, Lockheed's chief executive, said at a Bloomberg Government breakfast on Feb. 10.

"We're going to continue to focus on encouraging our lawmakers to take sequestration off the table and allow our customers to have the flexibility to make the decisions on where they spend their dollars to meet the national security needs of the country," Hewson said.

In an austere environment, companies seeking federal work have to be increasingly competitive on price.

"You knew there had to be downward pressure on the defense budget and the overall federal budget," Tony Smeraglinolo, chief executive of Chantilly, Va.-based Engility Holdings, said in an interview. "Price became much more of a determinant in who's going to win jobs. You need to get more price-sensitive."

The month's third-biggest contract went to Fairfield, Conn.-based GE. The company was awarded a \$572.5 million Navy agreement for engine work tied to F/A-18 and EA-18G aircraft, according to a Jan. 2 announcement.

United Technologies' Sikorsky division got the No. 4 agreement in January. The \$549.9 million Army contract modification is for 37 Seahawk helicopters, according to a Jan. 9 announcement.

This is part of a five-year contract signed in 2012 that "continues to deliver the reliable and proven aircraft on which the Army and Navy depend," Frans Jurgens, a Sikorsky spokesman, said in an e-mail.

"GE Aviation is grateful for the opportunity to continue our collaboration with the Navy," said Matthew Benvie, a company spokesman, in an e-mail.

The biggest contract of the month was a five-year agreement valued at as much as \$776 million for construction equipment. The Defense Logistics Agency awarded the deal on Jan. 28 to Wright & Wright Machinery, a closely held company based in Monticello, Ky.

The Navy on Jan. 14 announced a \$593.1 million contract award, the second largest of the month, to a division of San Francisco-based Bechtel Group for nuclear propulsion components.

The logistics agency awarded the fifth-biggest contract, \$288 million, to Voorhees, N.J.-based American Water Works on Jan. 9 to operate and maintain the water and wastewater systems at Hill Air Force Base in Utah for the next 50 years.

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