October 5th, 2010

Service Budget Realities

PSC Annual Conference - 2010

Nemacolin, PA

Presented by:

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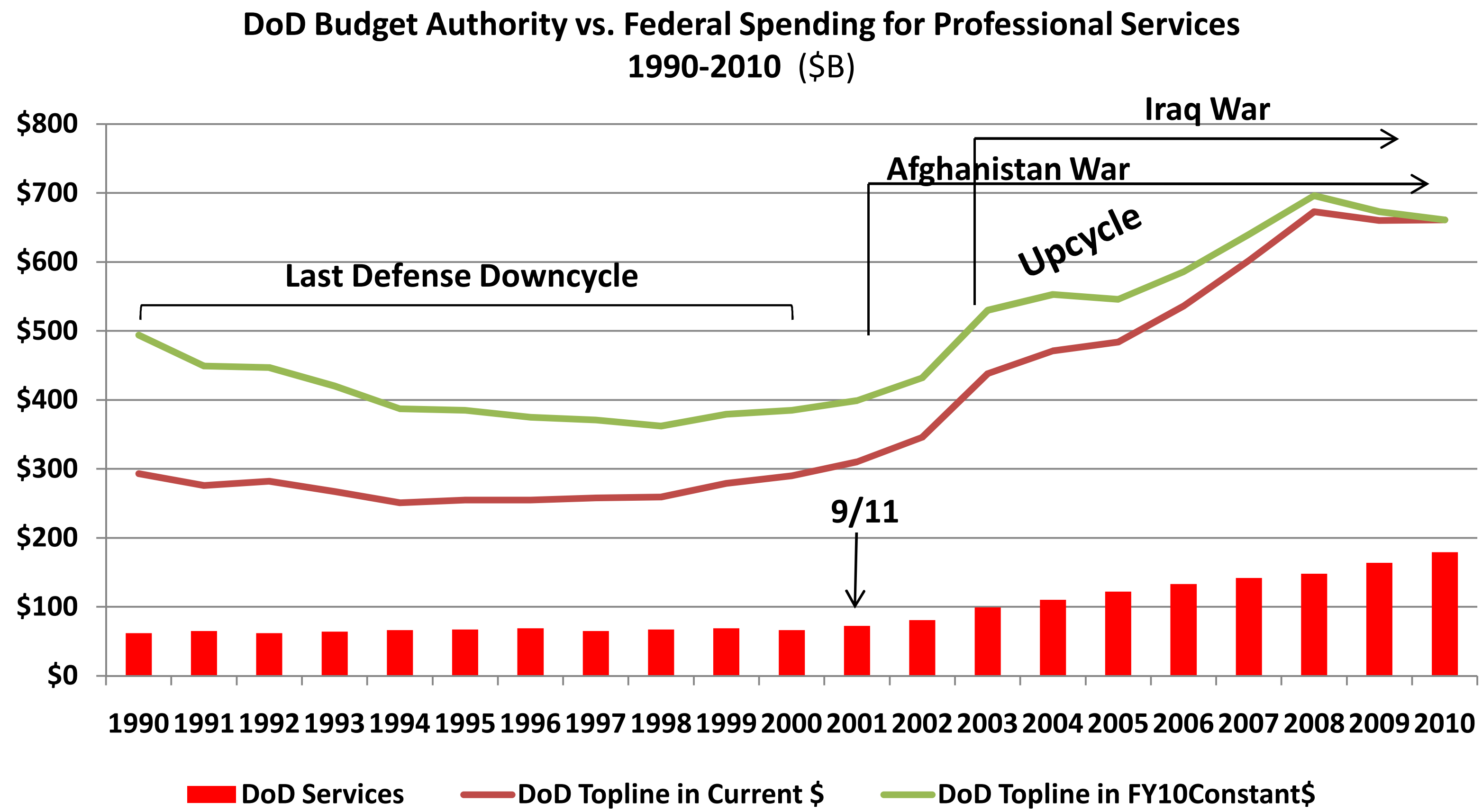
Agenda

- Long-cycle view
- Recent Services Industry Growth
- Future Growth Drivers/Limiters
- New Taxonomies
- Alternative Perspectives
- Industry Impacts

SourceRSAdvisors Analysis

PSC Budget Realities | **In the last downturn, Defense spending on Services stayed steady until 2001**

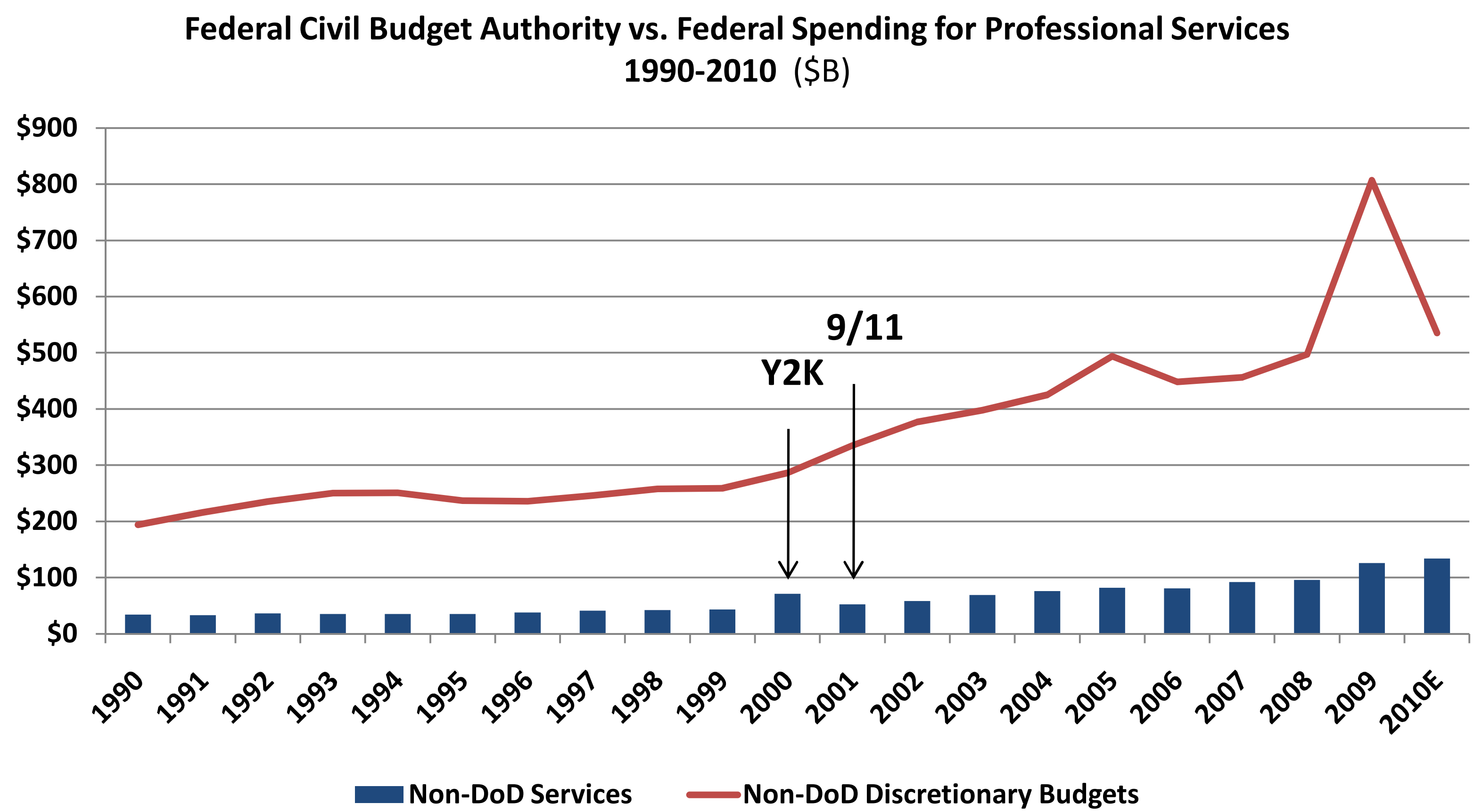


	CAGR 90 - 00	CAGR 01 -10
DoD Services	1.2%	9.5%
Topline in Current $	-0.5%	7.9%
Topline in Constant $	-2.9%	5.2%

Sources: Federal Procurement Database System, OMB, Defense Budget Material, RSAdvisors analysis

PSC Budget Realities

Federal Civil services growth lagged Non-Discretionary budget growth until Y2K; from that point services advanced at twice the budget growth rate



	CAGR 90 - 99	CAGR 01 -10
Federal Civil Services	2.6%	9.5%
Non-DoD Discretionary Budgets	3.3%	4.8%

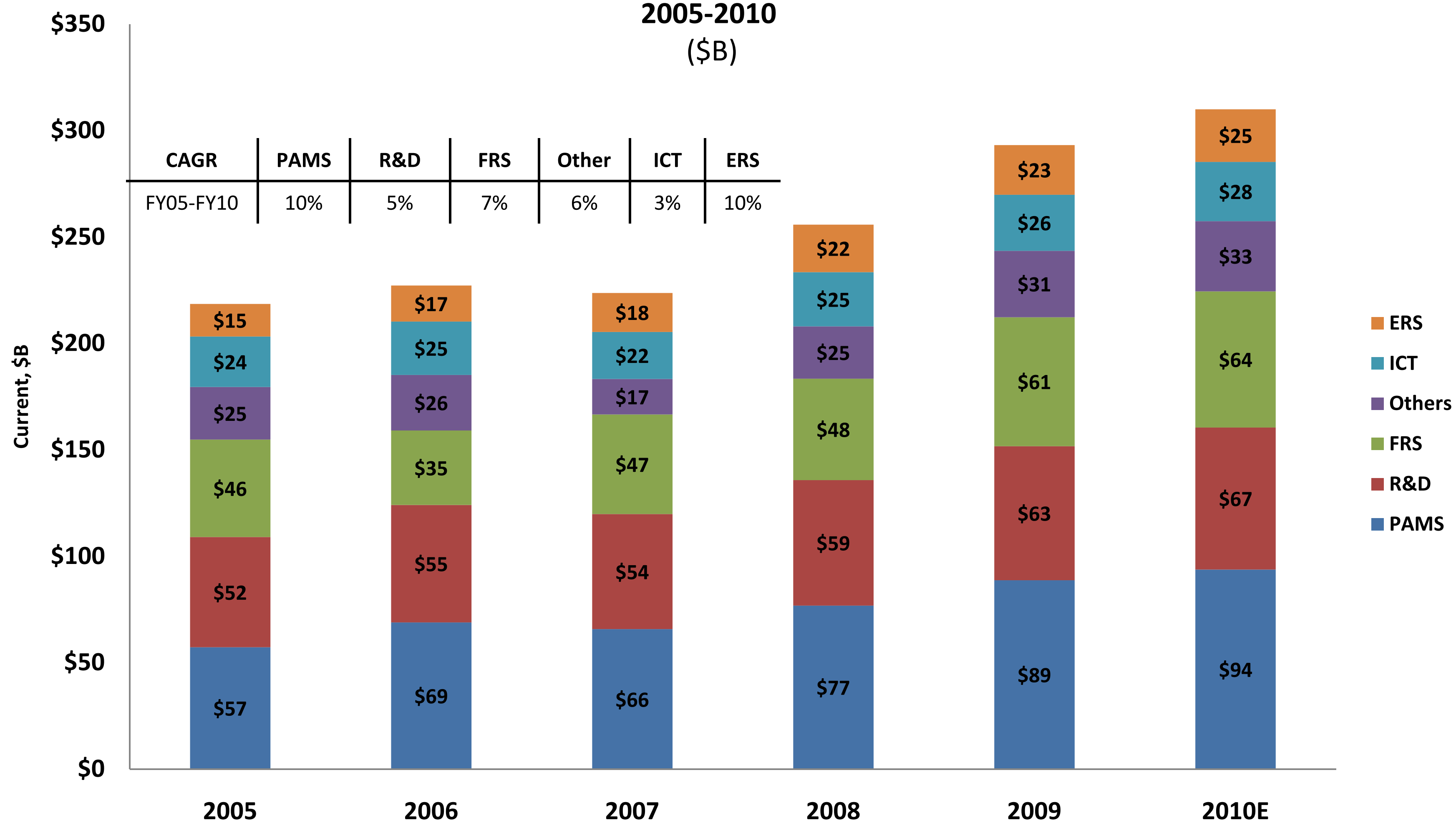
Sources: Federal Procurement Database System, OMB, Defense Budget Material, RSAdvisors analysis

PSC Budget Realities

From a traditional viewpoint, Professional and Administrative and Equipment services sectors grew fastest over the past 6 years

Total Spending on Federal Professional Services
2005-2010
($B)

CAGR	PAMS	R&D	FRS	Other	ICT	ERS
FY05-FY10	10%	5%	7%	6%	3%	10%

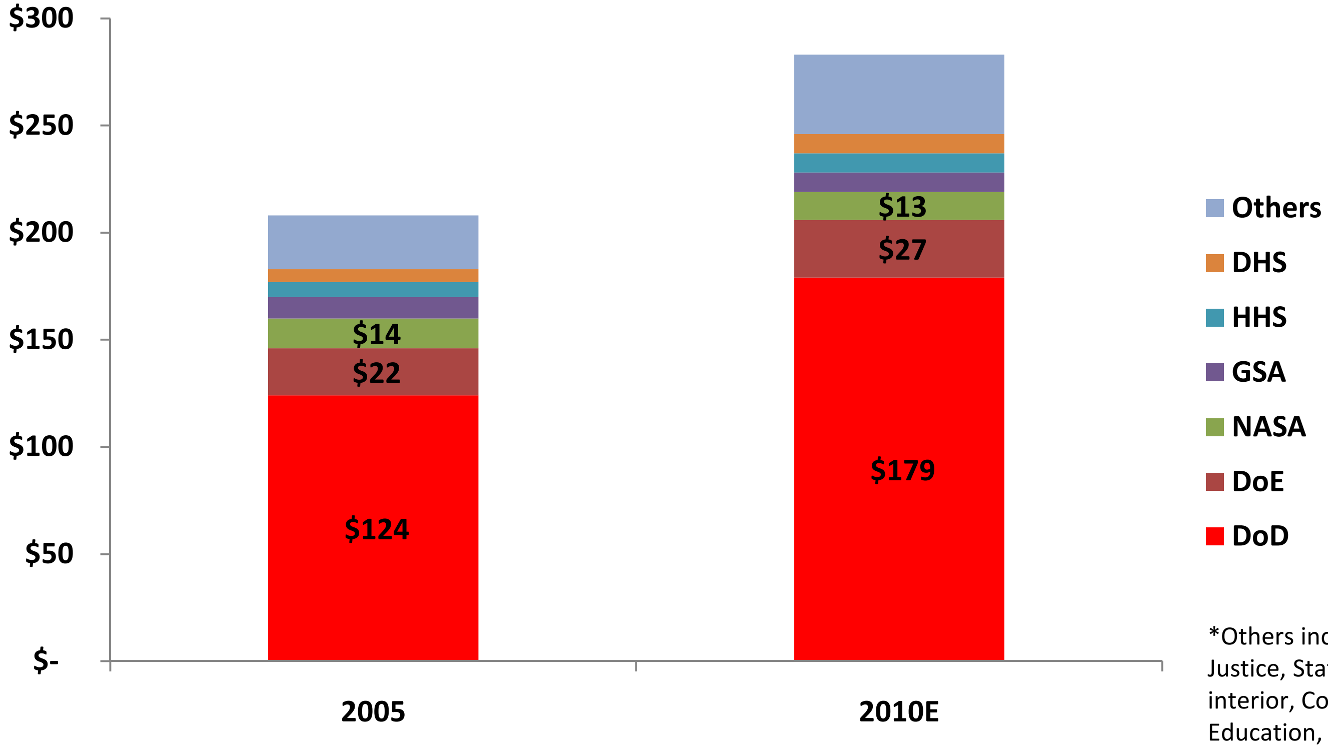


Sources: Federal Procurement Database System, OMB, Defense Budget Material, RSAdvisors analysis

DoD and DoE are the largest customers ; HHS and DHS are significant and have grown quickly over the past half decade

Total Spending on Professional Services by Customer
2005-2010
($B)

CAGR	DOD	Energy	NASA	GSA	HHS	DHS	Others*
FY05-FY10	8%	5%	-2%	-3%	6%	8%	1%



*Others include: VA, USAID, Justice, State, Transportation, interior, Commerce, Labor, EPA, Education, HUD, OPM, and Other Agencies

Sources: Federal Procurement Database System, OMB, Defense Budget Material, RSAdvisors analysis

Primary Forces Driving/Limiting Services Growth in Near-Term

- **US Macroeconomic and Federal Deficit conditions**
- **Timing of further drawdown of US Iraq presence**
- **Conditions on the ground in Afghanistan**
- **Stimulus funding burnoff**
- **Defense Department Efficiencies Initiatives**
- **Insourcing efforts**
- **Companies shedding OCI assets**
- **New and existing program cutbacks – DoD and Fed Civil**
- **Continued Cyber and terrorist threats to US and US interests**

SourceRSAdvisors Analysis

Cautious Optimism for Services in the Near-Mid Term

- Wars not concluded
  - Iraq presence still large
    - Only Afghanistan and Germany have more US troops in-country OCONUS
    - SOF Agreement likely extended beyond 2011
    - Demand up for security, log, and equipment services with recent drawdown
  - Afghanistan
    - Significant 2011 redeployment looking unlikely
    - NATO forces rely heavily on US support
    - Gen Petraeus indicating “Korea-like” commitment needed
    - Significant regional development assistance required
- Historical experience
  - Services spend declines modest in current dollar terms in the past
  - All Services do not move in same directions or rates
  - Insourcing results “unsatisfactory” to date
- Congressional resistance
  - Neither Dems nor most Reps rushing to gut defense
  - Specific program kills approach galvanizes delegations

Source: RSAdvisors Analysis

Given all of the Factors influencing Federal budgets and Services spending over the next couple of years, expect to see general customer trends as follows

Department	Overall Trend/Growth FY10-FY12
DoD	Flat – Down 1-2%
DoE	Up – 2-3%
NASA	Flat
State/USAID	Up - 2-4%
VA	Up – 4%+
Others	Flat – Down
Overall	Moderately Down 1-3%

Note: These are general trends. There are multiple submarkets within each major Department and no two Services suppliers compete with exactly the same set of resources

SourceRSAdvisors Analysis

Looking to the future, our "market taxonomy" for services will change…

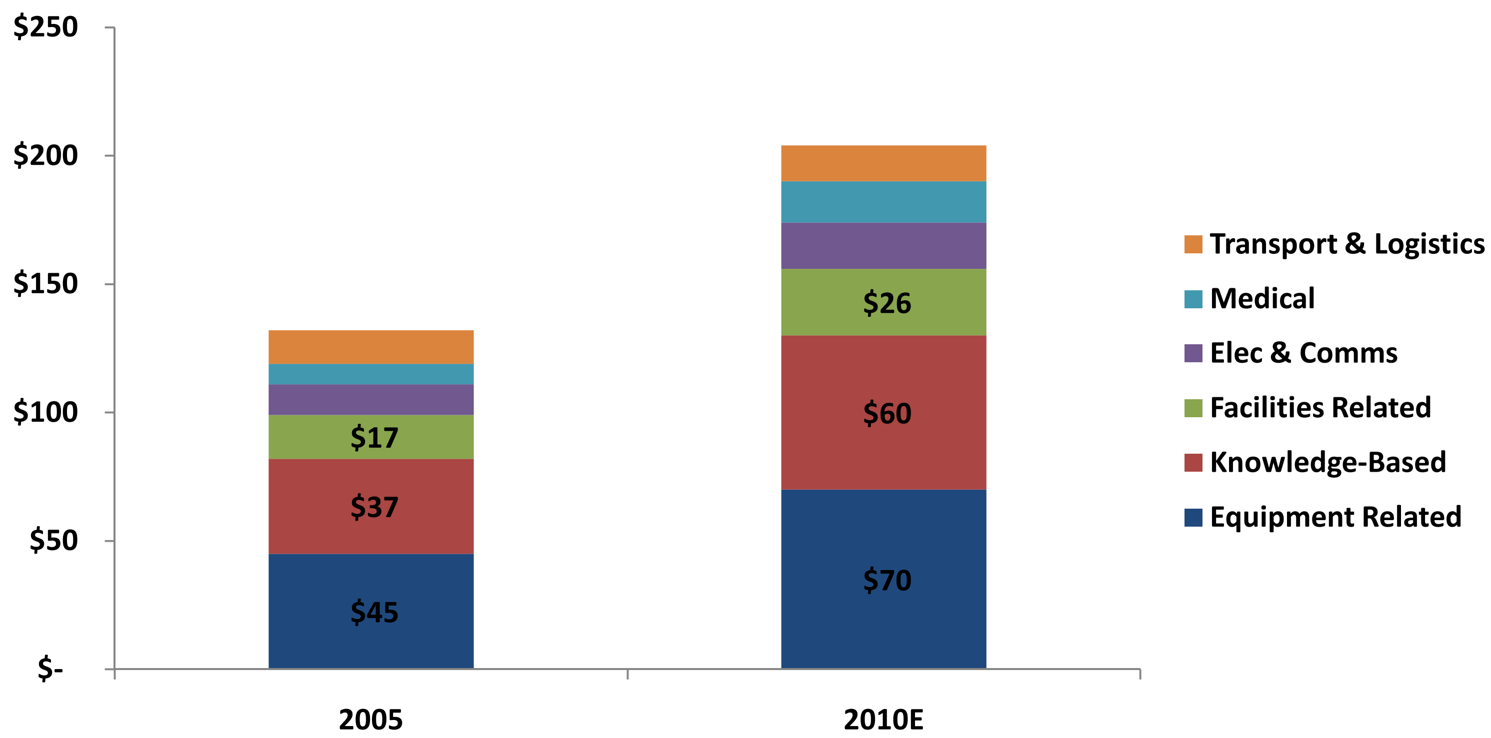
Category	Characteristics
Knowledge-Based Services	Research & Development, Natural Resources Management, Photo, Map and Publication, Social Services, Special Studies, PAMS
Equipment-Related Services	Maint/Repair of Equipment, Inspection and Quality Control Services, Installation Service, Lease/Rent of Equipment, Tech Rep Services
Facility-Related Services	Base Operations and Sustainment Services, A&E Services, Utilities & Housekeeping Services, Lease/Rent of Facilities, Maintenance & Repair of Real Property
Electronics & Communications Services	Programming, IT Systems Analysis, IT Facility & Network Management, Enterprise IT Services, Software Development
Medical Services	Managed Insurance Services, Doctor and Nurse Staffing, Surgery, General Medical Services, Laboratory Testing, Specialized Medical Services
Transportation Services	Logistics and Supply Chain Management, Rail, Air Cargo, Distribution Services, Courier & Messenger Services

Source: Department of Defense, RSAdvisors analysis

The Defense Services Market broken out by the new Taxonomy…

New View of Total Defense Spending on Professional Services (our estimates)
2000-2010
($B)

CAGR	ERS	KBS	FRS	ECS	MS	Trans
FY05-FY10	9%	10%	9%	8%	14%	2%



Sources: Federal Procurement Database System, RSAdvisors analysis

An Alternate View of DoD Services Markets

Support Activity Priorities Framework for Contracted Services FY11 – FY13

Government Priorities	Service Industry Assistance: Knowledge Management	Electronics & Comms (aka IT & Networks)	Equipment-Related Services	Facilities-Related Services	Transport & Logistics	Medical Services
Must Do's	• Strategic Intel Systems • Service Basic & Adv Indiv Training	• Maint DoD & Comm'l comm links • Hardening of Cyber nets • Further Dev Offensive Cyber/Exploit	• Support Land, Air, Sea Vehicles in Iraq/Afghan • Maint Strategic Forces platforms	• Critical Infrastr Maintenance • Support for Iraq/Afghan Ops	• Support to US Iraq/Afghan forces • Maintain core MilService & DLA logistics infrastructure	• Wounded Warrior care • Deployed Medical • Dependent Care • Retiree Care
Should Do's	• Proficiency training • Lessons Learned Anal	• Bus Process Improvemnts • Bus Transformn	• Reset • Depot Maint at minimum sustainable rate	• Facilities Maint ex CENTCOM • Guam/Pacom expansion	• Maintaining current field support structure	• Records Automation
Policy Desires	• Expanded Virtual Reality Trng	• Admin IT modernization	• Upgrades not In-combat or deemed marginal	• Green Facilities	• Fully-Integrated tracking	• n/a

On-Going Tension

Government ⟵ ***Performance*** ⟶ *Contracted*

An Alternate View of Fed Civil Services Markets

Support Activity Priorities Framework for Contracted Services FY11 – FY13

	Service Industry Assistance					
Government Priorities	Knowledge Management	Electronics & Comms (aka IT & Networks)	Equipment-Related Services	Facilities-Related Services	Transport & Logistics	Medical Services
Must Do's	• Program execution tracking and accountability mprovement	• Build core enterprise data Systs • Hardening of Cyber nets	•Maintain & Expand anti-Terrorist systems • Public safety	• Critical Infrastr Maintenance • Support for Iraq/Afghan Ops	• Focus on buying and travel efficiencies	• Improve HHS/CDC disease tracking & anal ysis
Should Do's	• Improve Grants experience capture • Staff training float	• Bus Process Improvemnts • Business Transformtn	• Upgrade and maintain air, land, sea utility fleets	• Refurbish national scientific infrastructure • Bldg facilities maintenance	• Maintaining current field support structure • Reducing carbon footprint	• Records Automation
Policy Desires	• Transparency expansion	• Admin IT modernization	• Upgrades not In-combat or deemed marginal	• Green Facilities	• n/a	• n/a

On-Going Tension

Government ⟵ ***Performance*** ⟶ *Contracted*

Impacts on Services Industry

- Customers will seek "lowest cost" until they realize they need "best sustainable value"
  - Must Do's will get done – risk/past performance counts here
  - Other activities to lowest bidders until enough mistakes bring customers back
  - "Affordability" will permeate all procurement decisions
- Flattening overall market will drive operational and staffing focus
- Competition will increase
  - Recompetes even more critical to maintain or take share
  - Execution becomes the differentiator
  - Customer intimacy even more important than in rising markets
- Restructuring
  - Already happening
    - Strategics – P/E, Private – Strategics, P/E – P/E
  - Consolidation likely as scale becomes critical for even further efficiencies
  - Knowing what you are and aren't good at will drive portfolio shaping

Source: RSAdvisors Analysis

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