



Current Issues & Themes In Offset



Welcome!

In these newsletters we provide our clients and industry partners with an independent assessment of the latest developments in Offset and related issues. Our aim is to communicate what we have learned through practical experience in our consultancy work, together with latest legislation, industry developments and best practice. Please feel free to contact us with questions, comments or queries on contact@Offsets2000.com.

Market Spotlight: United States

The United States is the world's largest defence market, yet remains one of the most difficult to penetrate using traditional means. The US distaste for offset is augmented by protectionist policies effectively keeping out foreign imports, preserving American jobs and technology in America. As any British or European defence companies will tell you, the only credible way to make significant sales to the US defence market is effectively to 'transfer work and technology to the US, or to acquire US companies.' In any other situation this would be called offset!

In a week that has seen the U.S. Navy award a \$250 million V-22 contract to Raytheon, and the U.S. DoD announce its intention to award \$227 million to various

academic institutions to perform multidisciplinary basic research, it must be acknowledged that India's upsurge notwithstanding, the U.S. defence market remains a formidable defence industry market.

Whilst the U.S. has no Offset rules, regulations or guidelines and is, as a collective, vehemently opposed to the concept, the Buy American Act (1933) remains a significant hurdle for many would-be defence suppliers to the American market. Purists will argue that the Buy American Act does not in fact apply to EU member states, WTO GPA parties (including Japan, Korea, Switzerland, Israel and Norway amongst several others) or NAFTA members Canada and Mexico. However, when one factors in U.S. Defence Export controls and ITAR (International Traffic in Arms Regulations) that make it particularly onerous for U.S. companies to issue technical data to non-US companies against RFPs for example, even the most single-minded purists are often forced to admit that it is difficult for a non-U.S. defence company to sell into the U.S. defence market unless they have a U.S subsidiary. Such difficulties have prompted companies like Finmeccanica and Chemring to invest heavily in the U.S in order to increase its direct industrial presence. Such necessary practices of course negate the need for Offset regulations.

As November draws nearer, so too does the contract-award announcement of the KC-X tanker program, estimated to be worth \$35billion. The controversial program to replace an ageing Boeing fleet with next-generation aerial refuelling tanker

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aircraft has been well documented, with several industry observers claiming that the latest RFP favours the Boeing solution. Rainer Bruederle, Federal Minister for Economics and Technology criticised the document, reportedly going so far as to say "...free trade should not be curtailed. Particularly in the current economic downturn, event indicators of protectionism are damaging." EADS however, who are bidding alone (their U.S.-based prime contractor partner Northrup Grumman pulled out of the competition in protest) remain confident that they have a good chance of winning the competition with their Airbus A330-200-based solution, and Louis Gallois, EADS CEO has been quoted as saying he believe EADS have "a fair chance to win".

Protectionist or not; ill-disguised Offset or not; it should be remembered that those same export controls that make it difficult for non-U.S. companies to bid into the American market, also limit and constrain export opportunities for U.S. companies. To illustrate, the Australian Government reportedly chose the EADS MRH-90 troop-lift helicopters over the Sikorsky offering because "the European bid offered the ADF better access to crucial computer source codes than the Sikorsky bid". The UK faced a similar situation when negotiating the JSF program, with Members of Parliament demanding guarantees that the

U.S. would release full technical specification to allow independent operation.

Still, U.S. defence firms are once again potentially at an advantage when part of an FMS bid-solution led by the U.S. government; As government to government contracts are largely exempt from Offset, the burden of delivery (and offset) is lifted from U.S. companies. In a recent fighter procurement programme in Romania, the Romanian government controversially selected second-hand F-16s over brand new Saab Gripen Fighters, the latter of which allegedly included an attractive Offset package and very competitive financing.

UK Defence Industry does not enjoy the same level of 'protection' as afforded its US counterparts, neither do the majority of European defence companies. This should not be taken to imply that US companies have an easy ride in the cut and thrust of international defence business. We should however react by developing business strategies that recognise US protectionist policies and, whether through acquisition or licensed manufacture, approach the US as if it were taking a traditional offset stance in relation to its home market.

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Special Report: FIA 2010

In a year that has seen tentative recovery in the civil aerospace industry almost thwarted by force majeure, the Boeing 787 arrival at the Farnborough International Airshow 2010 at 9:09am on the first morning of the event having completed its first transatlantic flight, sounded a much-needed rally cry – to both allies and competitors. And Offset, both civil and military will play its role.

From a UK Industry perspective, the show was almost unprecedented in the support received by the UK Government. Richard Paniguan, Head of the UK Defence & Security Organisation (UKTI DSO) is reported to have described the new government as “outstanding... forward-leaning, articulate and vocal in their support for [UK] defence exports”. That said, as austerity looms over even the healthiest of order books, Offset will become increasingly important as a means to leverage necessary defence spending as well as encourage innovative financing mechanisms.

Moreover as new entrants enter the defence export market, Offsets 2000 expects that we will start to see new more innovative types of Offset become increasingly common as companies play to their natural strengths.

Turkish Aerospace Industries for instance has now unveiled a new tactical medium-altitude, long-endurance UAV; Embraer of Brazil has launched its KC-390 program (military transport aircraft) and the Sukhoi PAK FAs (fifth generation jet fighters) that could seriously rival Lockheed Martin's F-22 Raptor are due to enter service in the next two years. Russia's mammoth aerospace program (as

evidenced by its presence at Farnborough) will have a particular impact on the global export industry and Offset in particular, as much of Russia's Offset is handled centrally by Robosoronexport. Particularly well-versed in countertrade and BOT as well as traditional Offset, Robosoronexport's handling of Offset matters is impressive. Similarly China's Chengdu J-10, already approved for purchase by the Pakistani government, is reportedly already enjoying interest from several other countries. Aviation Industries of China (AVIC) and the Chengdu Aircraft Industry Corporation (CAC) are expected to aggressively market the solution drawing on government support that will no doubt make any Offset or countertrade very attractive.

UK Industry then and all those wishing to compete against such weighty opponents will need to 'up their game' accordingly and realise that the traditional 'direct/indirect Offset' package, may not be enough.

A|D|S Offset Training Workshop – November 2010

The Offset Workshop held in Farnborough on 2nd July was considered a great success, with delegates drawn from a broad cross section of international defence industry; from defence companies to law firms and government bodies. The next in a series of Offset Training Workshops is to be held on 17th November in Farnborough. This Offset Training Workshop is to be held in conjunction with A|D|S and will be of benefit to all companies engaged in defence business. The workshop - of value to both novices and experienced practitioners - provides 'Best Practice' on Offset.

For more information please contact Christine Gomm at A|D|S on: Christine.gomm@adsgroup.org.uk.



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Best Practice – How to leverage new business from Offset

As in previous newsletters, we continue in this section to provide insight on Offset management and delivery gathered from our consulting experience.

As the prevalence of Offsets increases, Tier 2 & 3 suppliers and non-defence companies who would not ordinarily have their own obligations, are increasingly recognising that Offset can be leveraged as a business development tool. Suppliers to OEMs/Primes can set themselves apart from their competitors by providing Offset solutions to their customers in addition to their product offerings; If lower-tier suppliers can demonstrate as part of their proposals that as well as attractive pricing and superior technical capability they are able to reduce the eventual Offset burden that would be shouldered by OEMs/Primes, they can re-position themselves from being seen as a simple supplier to becoming a business winning solution for their customers.

Offsets 2000 is working with a number of companies in this regard to formulate blueprint projects and programmes that are in line with the typical operations of the firm, and to shape the internal procedures and mechanisms to allow the company

to design, implement and manage future Offset contributions. This includes the formulation of clear dialogue and reporting lines between purchasing, engineering and sales departments, procedural changes, raised awareness, life-cycle management etc).

In addition, lower-tier suppliers as well as non-defence companies should not overlook the opportunities associated with developing a holistic business strategy to obtain investment and business in new markets through Offset programmes.

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