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U.S. Defense Contractors Focus on Foreign Buyers

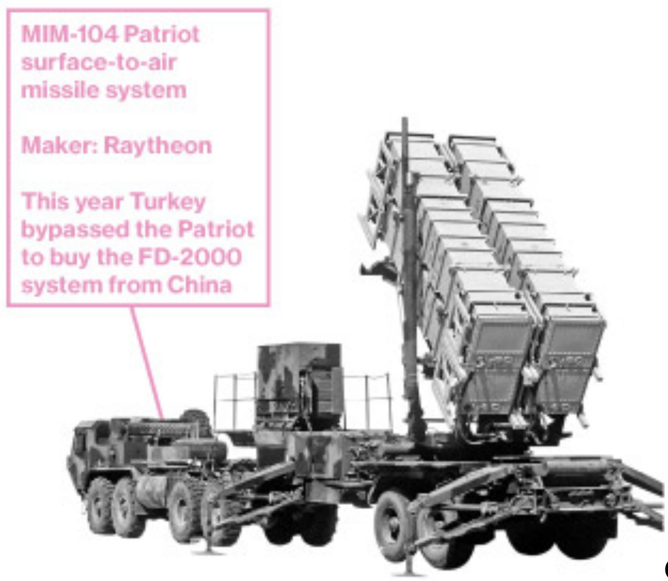
By David Lerman and Robert Wall November 14, 2013

It’s been more than a decade since the U.S. military bought any of Lockheed Martin’s (LMT) F-16 fighter jets. But manufacturing continues at the defense giant’s plant in Fort Worth, where about 400 workers turn out as many as two dozen planes a year, thanks to buyers that have included Israel, Oman, and Iraq. “International is the business that keeps the F-16 production lines open,” says Patrick Dewar, executive vice president of Lockheed Martin International, a division the world’s largest defense contractor created this year to boost foreign sales. “It was a recognition that our corporation had the capabilities to do more and deliver better to those customers,” he says.

Johannes Eisele/AFP/Getty Images

As U.S. military spending dwindles after more than a decade of war in Iraq and Afghanistan—and the across-the-board federal budget cuts known as sequestration threaten still-deeper reductions—defense contractors are looking overseas. “We’ve now turned up the heat on an already focused sales team to balance the sequestration effect,” says Robert Kokorda, vice president for sales and marketing at Sikorsky Aircraft, a unit of United Technologies (UTX) in Hartford. Sikorsky, which designs and builds helicopters such as the globally popular Black Hawk, gets 15 percent of its sales revenue from overseas, a share that could double in the next decade, Kokorda says. The company touts a recent Black Hawk deal with Taiwan, and another with Turkey that Kokorda says is valued at more than $1 billion over 30 years. Sikorsky is also competing to provide its Seahawk helicopters to India's navy. "If they all happen at the same time, they could fill in a lot from sequestration," he says.

International sales at Boeing's (BA) defense division made up 24 percent of the company's $33 billion in defense revenue last year, up from 7 percent in 2004, says spokesman Daniel Beck. Raytheon (RTN), the world's largest missile maker, raised its foreign revenue share to 26 percent last year, from 16 percent a decade earlier. "They're all looking for opportunities for growth at a time when the U.S. defense budget is declining," says Remy Nathan, vice president for international affairs at the Aerospace Industries Association, a leading trade group. "You go where the money is."



Courtesy Lockheed Martin; Defense Imagery

Yet finding overseas buyers for expensive weapons systems may become more difficult. Global defense spending last year contracted for the first time in 15 years as countries such as India and China slowed the growth of their militaries, says Siemon Wezeman, senior researcher at the Stockholm International Peace Research Institute's arms transfers program. The group reported that global military spending fell last year, to $1.75 trillion, a drop of 0.5 percent in real terms and the first decline since 1998.

As the market gets smaller, competition between U.S. and foreign companies is getting stiffer. Turkey, a member of NATO, announced in September that it would buy a long-range air defense system, the FD-2000, from China—passing up Raytheon's Patriot system and rival offerings from Europe's MBDA and Russia's arms export agency Rosoboronexport. The deal was widely seen as heralding greater sway for Beijing in coming years. "I think that surprised a lot of people," says Graham Smart, a defense consultant who works mostly with European companies trying to compete in the U.S. "You'll certainly see China being more aggressive in some of the same export markets in the Middle East and Asia. If they've suddenly popped up in the Turkish market, it probably isn't a one-off."

Competition from China was considered only a minor threat to Western companies just a few years ago. Its government-controlled defense industry had limited export success in niche markets such as Pakistan, where strong political ties helped it sell combat jets and drones, and Iran, which bought Chinese antiship missiles. China was able to undercut the competition in Turkey with a $3 billion bid, about $1 billion lower than had been expected, says Byron Callan, a defense analyst at Capital Alpha Partners. U.S. companies "are correct to try to pursue international market share," he says, "but it sure isn't a cakewalk."

The emergence of China as a major defense player poses challenges for U.S. contractors, who say they probably can't match Chinese defense companies strictly on price. "We don't win low-cost competitions," Lockheed's Dewar says. "That's not our DNA. At the end of the day, someone needs the capabilities we have."

South Korean defense contractors are also flexing their export muscle, says Håkan Buskhe, chief executive officer of combat jetmaker Saab, which is competing for plane orders with Boeing and others in markets from Brazil to Malaysia.

Exports are a vital lifeline for products the Pentagon no longer wants—or can't afford to buy. Boeing, which in September announced it would close its C-17 airlifter manufacturing line in 2015, had relied on overseas sales for years to keep the facility open. An order from Saudi Arabia for 84 of the company's F-15 fighter jets will keep that production line busy through this decade as the Chicago-based planemaker chases overseas buyers for its other combat jet, the F/A-18E/F Super Hornet.

Some analysts doubt U.S. contractors will ever be able to find enough foreign sales to make up for lost domestic business. In one measure of the potential gap, the Defense Security Cooperation Agency, which oversees sales of U.S.-made military equipment to foreign governments, forecast that overseas sales in 2013 will total $25 billion. The Pentagon, by contrast, will be forced next year to cut twice that much if sequestration remains in effect. "I do not believe international sales can quickly fill a $50 billion hole," says Steven Grundman, a defense analyst and George Lund fellow at the Atlantic Council. "There's not enough international market in the near term to fill that void."

Master Sgt. Benjamin Bloker/U.S. Air Force

Such doubts don't trouble Lockheed, where a backlog of orders for its F-16 Fighting Falcon jet will keep its Fort Worth plant busy at least through 2017. It's delivered 4,536 of the planes worldwide, with the U.S. buying only 1,445 of them. International sales amounted to about $8 billion last year, or 17 percent of its total revenue. That share could grow to 20 percent in the next few years, Dewar says. And the F-16 may serve as a role model of sorts for the company's newest warplane, the F-35 Joint Strike Fighter. Dewar says Lockheed envisions selling that plane abroad long after the Pentagon stops buying it. Over the next five years alone, he anticipates that nearly half the orders for the F-35 will come from overseas. "The demand is there," he says.

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