USAF LRS-B Award To Northrop Grumman Is Upheld

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Now that congressional arbiters have backed the U.S. Air Force and incumbent contractor Northrop Grumman over the Long-Range Strike Bomber (LRS-B) program, there are only two main questions left to be addressed.

For losing bidders Boeing and Lockheed Martin, do they sue one of their most important customers? For Northrop, can it deliver on the expected $80 billion program?

So far the respective answers are: 1.) We have not decided, and 2.) Of course we can.

Time will tell, but until then the Northrop-led team chosen in October to provide the Air Force's first LRS-B are enjoying a political and financial boost now that the Government Accountability Office (GAO) has affirmed the armed service's decision.

Boeing and Lockheed Martin, which had paired in a failed bid for the program, had protested the award in November, claiming the Air Force had not properly assessed and valued their proposed production improvements.

GAO federal contract referees, however, said the Air Force's decision followed procedure and denied the protest. "GAO reviewed the challenges to the selection decision raised by Boeing and has found no basis to sustain or uphold the protest," the agency said Feb. 16. "In denying Boeing's protest, GAO concluded that the technical evaluation, and the evaluation of costs, was reasonable, consistent with the terms of the solicitation, and in accordance with procurement laws and regulations."

GAO findings are not binding on executive branch agencies—due to the separation of powers in U.S. government—but they nonetheless carry great weight and receive widespread deference. Executive branch agencies often follow their recommendations or are compelled by Congress to explain why not. And while Boeing or Lockheed still could sue the Air Force in federal court over Northrop's award, the judicial branch often looks to GAO decisions, if any, as a guidepost.

Credit: Jozef Gatial

For its part, Boeing remained unbowed. “We continue to believe that our offering represents the best solution for the Air Force and the nation, and that the government’s selection process was fundamentally and irreparably flawed,” the company said. “We will carefully review the GAO’s decision and decide upon our next steps with regard to the protest in the coming days. Given the significance of the LRS-B program, it could not be more critical that the government procure the most capable bomber to serve the warfighter, at the greatest value to the American taxpayer.”

Northrop, not surprisingly, said it was “pleased” and “delighted” to resume work on the future bomber—confirming earlier suspicions it had stopped work, as is customary, while GAO reviewed the bid protest and that the Air Force had not insisted otherwise. “This confirms that the U.S. Air Force conducted an extraordinarily thorough selection process and selected the most capable and affordable solution,” the company said.

A Pentagon spokesman similarly told reporters that the GAO decision affirms the award. “From our standpoint, we were confident in the original decision,” Peter Cook said.

The GAO’s decision did not surprise many observers, although some doubt over the outcome emerged this month when the Air Force acknowledged it removed acting acquisition chief Richard Lombardi after he reportedly admitted failing to list his wife’s retirement account at Northrop on his annual financial disclosure forms. But service leaders asserted Lombardi was not part of their LRS-B award, which was shepherded by William LaPlante, the recently retired acquisition chief.

Defense investor analyst Byron Callan of Capital Alpha Partners had predicted only a 15% chance of a successful Boeing protest before the GAO decision. Nevertheless, assuming Boeing and Lockheed do not prevail in court or in Congress, where they could lobby for relief, the onus will quickly turn to Northrop to make good on its contract award.

“For Northrop Grumman, the primary issue now that GAO has rendered its decision is to develop the aircraft and its systems within cost and schedule estimates,” Callan says. “This remains a risk, in our view, for the 2018-20 time frame given the pace of the program.”

Still, with unspoken assurances from Northrop during recent year-ahead forecasting, Wall Street had already factored a GAO victory into the suburban Washington defense contractor’s financial expectations for the coming years.

Cowen and Co. analysts told investor clients in January and February notes that their 2016 revenue-growth projections at Northrop assume “modest sales” initially due to LRS-B. That is because the engineering, manufacturing and design contract ramp-up would be “gradual” as engineers are hired and get security clearances. Yet revenue growth should accelerate at least at a 5% pace in 2017-18, according to Cowen.

Jefferies analysts concur. “We would estimate LRS-B contributes an incremental $300 million from 2015 levels,” they said Jan. 29. “Management has factored in a month-by-month step-up.”

For Boeing and Lockheed, investors have other issues to consider. While the Air Force’s T/X trainer effort remains an opportunity for both, each has challenges to address now, according to Callan.

“For Boeing, this places more pressure on the company to secure an F/A-18 sale to Kuwait and another of F-15s to Qatar,” he says. “For Lockheed Martin, the decision means the company can focus on completing development of the F-35, drive unit costs down and address spares issues that have vexed the Defense Department.”