

October 16-17, 2013

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Vision Federal Market Forecast

Press Briefing

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Vision Federal Market Forecast Macro & Defense Topline Forecast

**TechAmerica Foundation
Spokesperson, Trey Hodgkins**

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Key Macroeconomic Trends

- **Health of worldwide economy is mixed**
 - US real GDP growing at <2% for the past 4Qs; economic and market indicators are mixed
 - Emerging Markets, Asia-Pacific boom
 - Increasing concerns about China, int'l finance
 - EuroZone slowly recovering from recession
- **US deficit story is more positive than in previous years**
 - Legislated savings (e.g., BCA, ATRA, CRs), combined with one-time increases in tax revenues, have led to >\$2T in reductions
 - \$1T deficits have passed; now in high hundred \$B range (FY15-23)
 - CBO projection of public debt/GDP at 71% for FY23 (Sept 2013)
- **Financial market concerns about eventual changes to Federal Reserve quantitative easing, interest rate policies**
- **Political system digesting only incremental budget deals**



An improving economic situation is redirecting the deficit debate, but the broader structural debt problem remains in place

Discretionary Forecast Drivers

- **CR at BCA sequester levels for 3-6 months**
- **FY 14 full or partial sequestration**
 - FY14: Exempt the Department of Veterans Affairs and DoD MILPERS
 - FY15: Parallel OMB's guidance of 5-10% below FY14 projection
- **Sequestration's effect reduces the FY15-17 baseline**
 - Expect discretionary to be reduced by several hundred \$B more
- **Administration outyear cuts of \$260B will hold**
 - Closes BCA-sequestration distance further in the outyears
- **DoD takes an increasing share of discretionary cuts**
 - BCA ratios hurting defense more than non-defense
 - Post-war drawdown to go on for several more years
- **\$1-2T in deficit reduction still needed over the long-term**
 - Rating agencies, markets still see the US debt problem as substantial

Expect hundreds of \$B more in discretionary cuts from initial BCA caps

Alternative Discretionary Forecasts: FY14-24

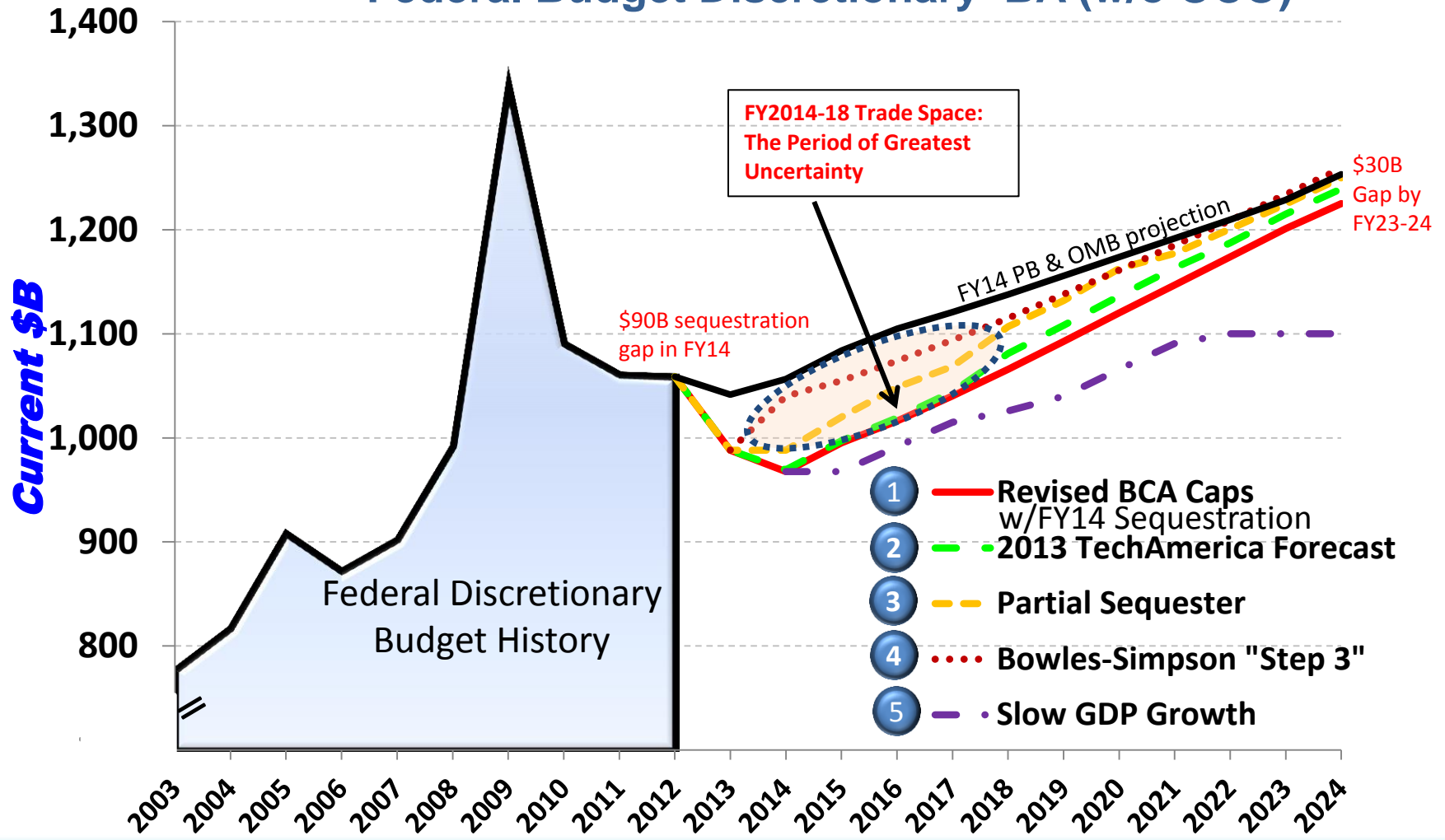
Likelihood
Estimate

- **Scenario #1: Sequestration “Red Line”** (10%)
 - Enforcement implemented in winter of 2014, on-going for 10 years
- **Scenario #2: TechAmerica Forecast** (40%)
 - FY13-15 full sequester; inflation only for FY16-17
 - \$597B below FY14-24 PB projection, plus \$145B OCO savings
- **Scenario #3: Partial Sequester** (30%)
 - FY13 sequester; FY14: half-year CR/70% partial sequester
 - \$338B below FY14-24 PB projection, plus \$145B OCO savings
- **Scenario #4: Bowles-Simpson “Step Three”** (5%)
 - No FY14 sequester; spending indexed to inflation
- **Scenario #5: Slow GDP Growth/Recession** (15%)
 - Economic downturn precipitates sub-BCA reductions
 - \$1.25T below FY14-24 PB projection; \$590 below BCA “red line”

*TechAmerica forecast assumes FY13-15 sequester,
an upward FY18 DoD adjustment, and inflation-only in the outyears*

A Narrower Budget Pathway

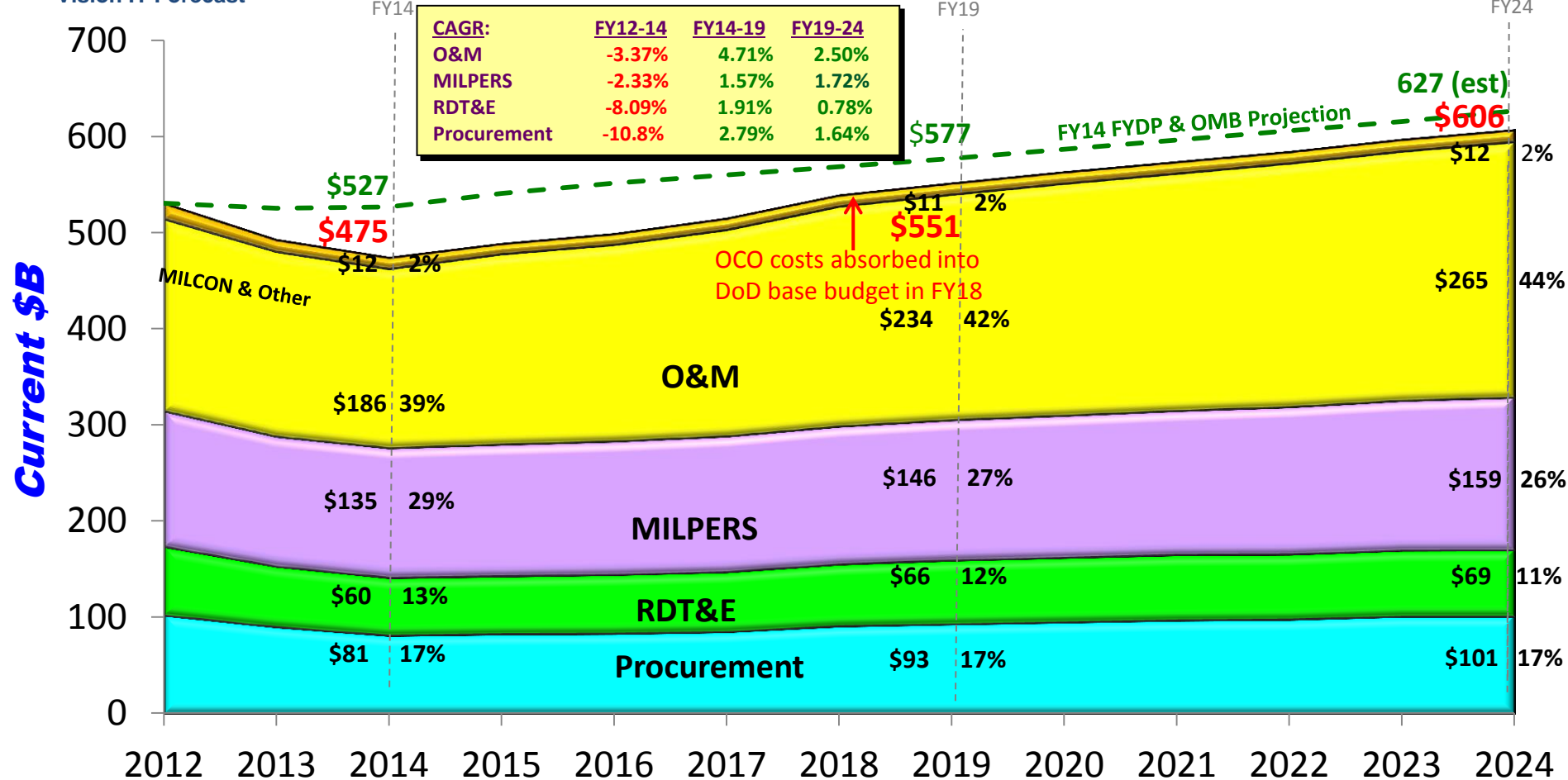
Federal Budget Discretionary BA (w/o OCO)



Further discretionary cuts will be front-loaded (FY14-FY18), as the remaining trade space is greatest in those years

DoD Base Budget Forecast in Current Dollars (discretionary only)

Vision IT Forecast



- O&M: Growth in FY15-16; includes \$8-10B for costs of Afghan residual force beginning FY18 after the OCO is ended
- Procurement takes deeper FY12-14 sequestration hit, only to gradually recover in the outyears (FY15-24)
- Congress will not provide BRAC authorization, approve proposed TRICARE fee initiatives or hold military pay raise to 1%

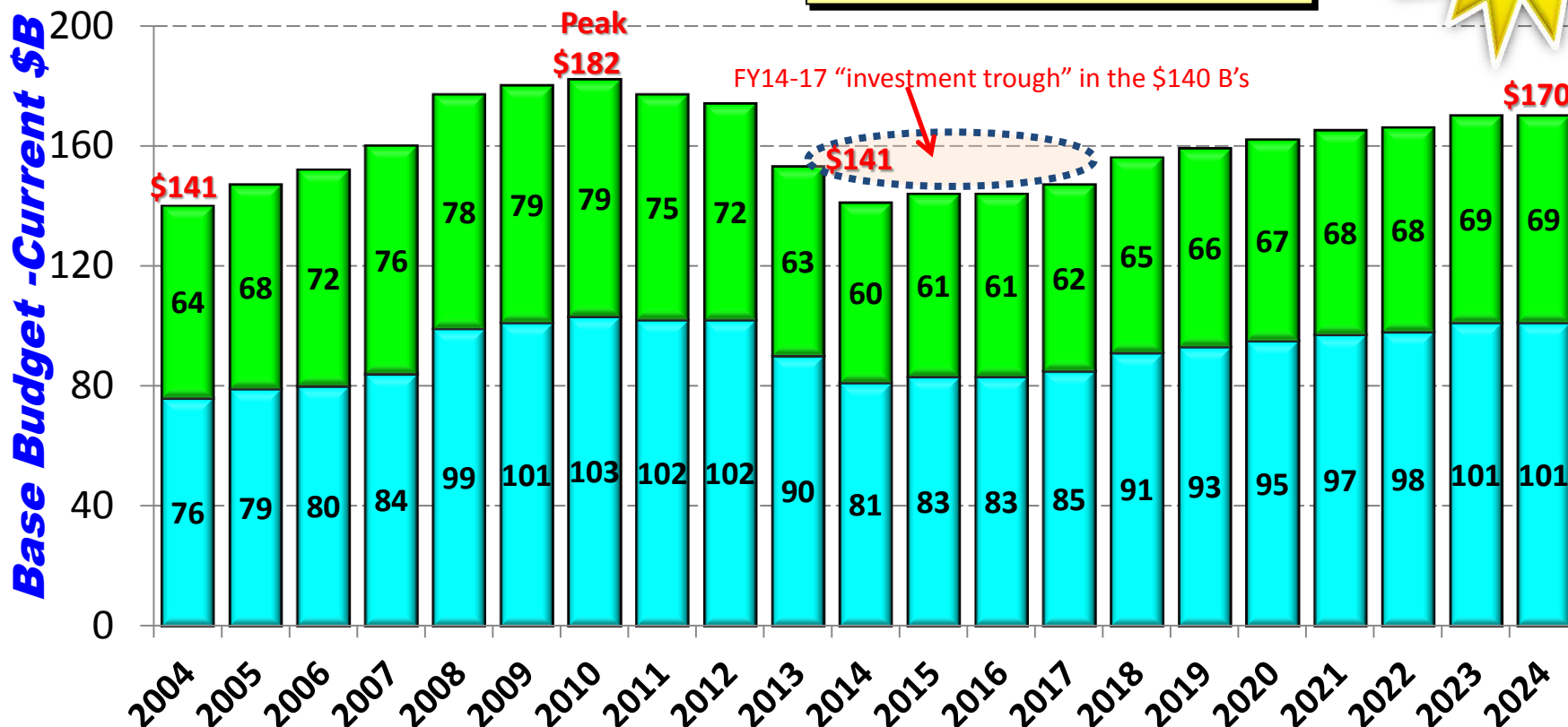
TechAmerica forecast drops DoD base under \$500B from FY13-16, absorbs OCO into base in FY18, followed by inflation-only growth

Investment Has to Build Back from Sequestration, Drawdown

■ Procurement ■ RDT&E

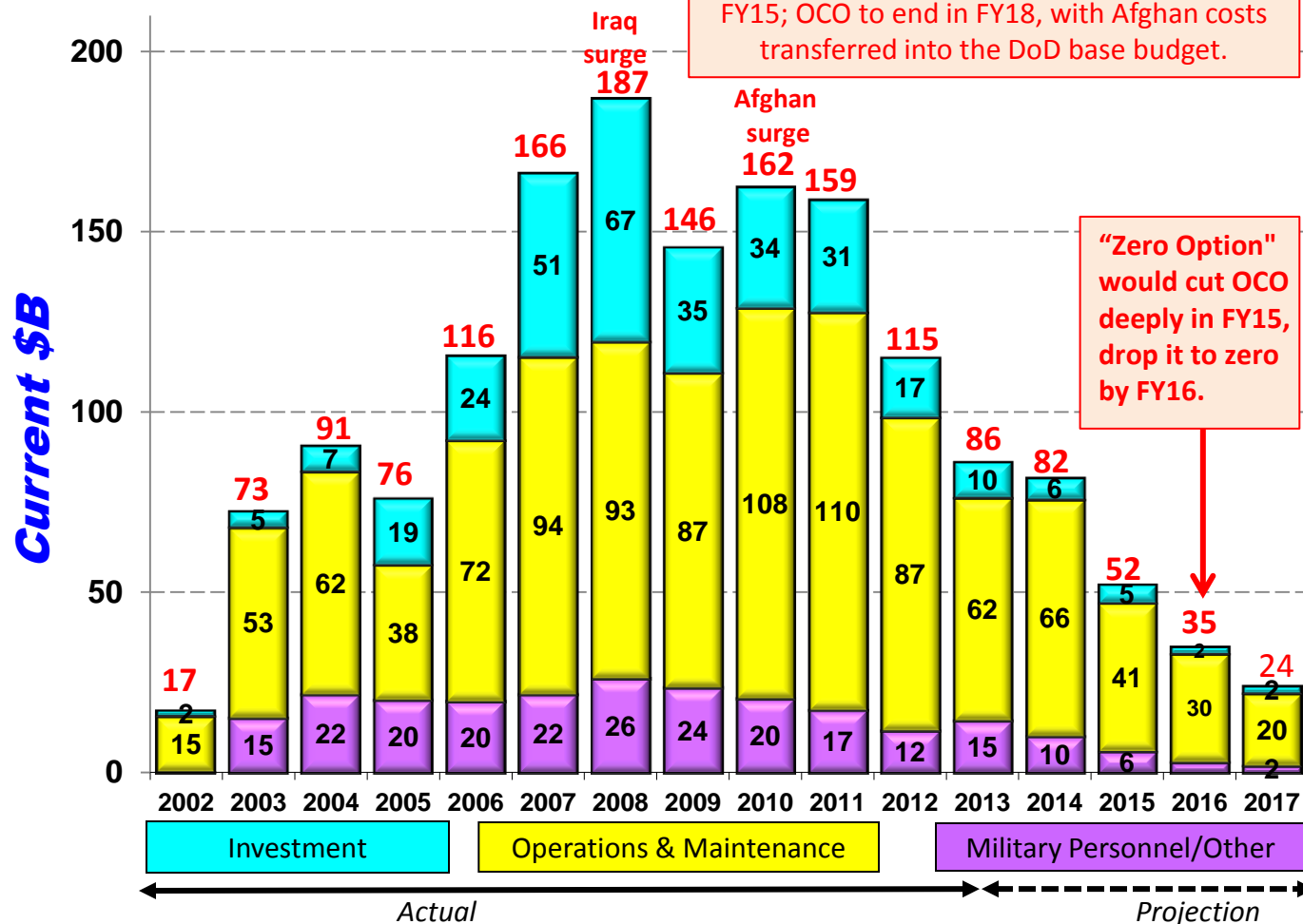
CAGR:	FY12-14	FY14-17	FY17-24
Investment	-9.98%	1.40%	1.49%

1.46%
CAGR
2014-24



"Triple whammy" in FY14-17: sequestration effects, DoD base decline, O&M buy-back will drop Investment; Procurement to R&D ratio of ~ 3:2

Overseas Contingency Operations (OCO) Forecast



Major Assumptions

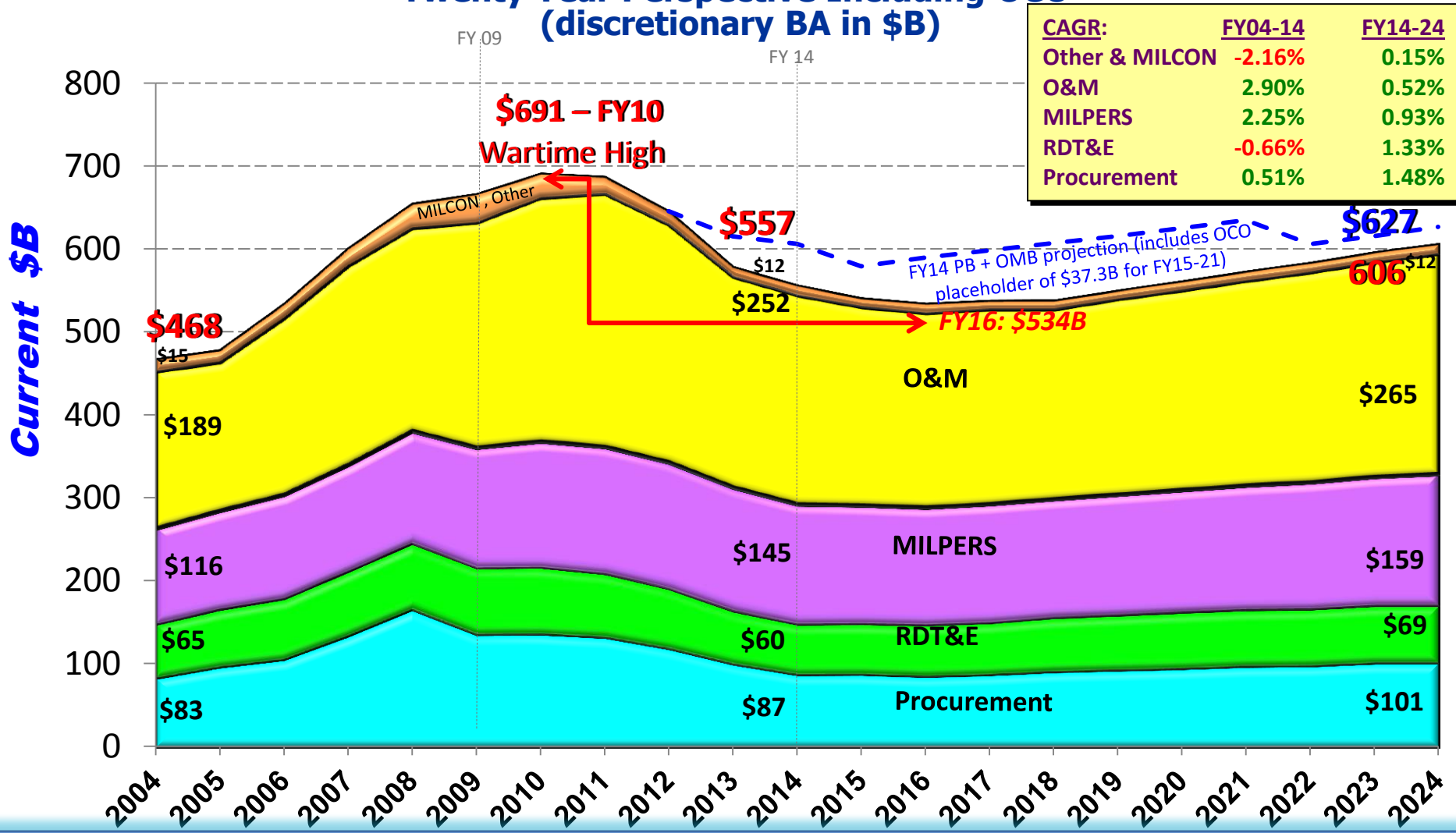
- ◆ US forces down to 34,000 by Feb 2014; combat forces withdrawn by Dec 2014.
- ◆ Increased costs due to faster pace of FY14 and prior year operations, FOB closures, retrograde; continues into FY15-16.
- ◆ Average annual US force levels in Afghanistan: 89K - FY12; 63K - FY13; 38K - FY14; 12K - FY15-17.
- ◆ Afghans retain the lead for security in all areas of country.
- ◆ Post-FY17 residual force of 10K: training, SOF, advisory assistance, helo/air support.
- ◆ US presence in CENTCOM region through FY24: ~20-25K.
- ◆ \$4-5B support to ANSF.
- ◆ Political "wild card" – status of negotiations with Taliban.

"Today, the core of al Qaeda in Afghanistan and Pakistan is on the path to defeat."

Remarks by President Barack Obama at National Defense University, May 23, 2013

DoD Topline Forecast

Twenty Year Perspective Including OCO
(discretionary BA in \$B)



Topline drops deeply in FY13-14 due to sequestration and lower OCO costs;
bottoms out in FY16-18, followed by inflation-only gains

Risks to Industry: Severe in the Next 2-3 Years

■ Macro-economic risk indicators

- US credit downgrade leads to years-long interest spike
- Real US GDP growth remains stuck in 1-2% range
- Sequestration extends into FY15 and beyond
- Federal Reserve, under new Chair, makes early changes to quantitative easing, federal funds rate policies

■ DoD risk indicators

- DoD management of O&M shortfalls (base and OCO)
- FY14 sequestration financial management, planning
- Earlier force structure/end strength decisions
- Resource management of the rebalance to Asia-Pacific

■ Political/policy risk indicators

- Gridlock on Capitol Hill provides “no way out”
- Mini-bargain eases sequestration’s pain
- “Big Deal” leads to pathway out of BCA, sequestration

Sequestration Cuts



GDP Growth



Interest Rates



2014 is your critical year!

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IT Budget Forecast

**TechAmerica Foundation
Spokesperson, Robert Haas**

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Agenda

- **Top issues**
- **IT Forecast**
- **Emerging Opportunity Areas**
- **Summary**

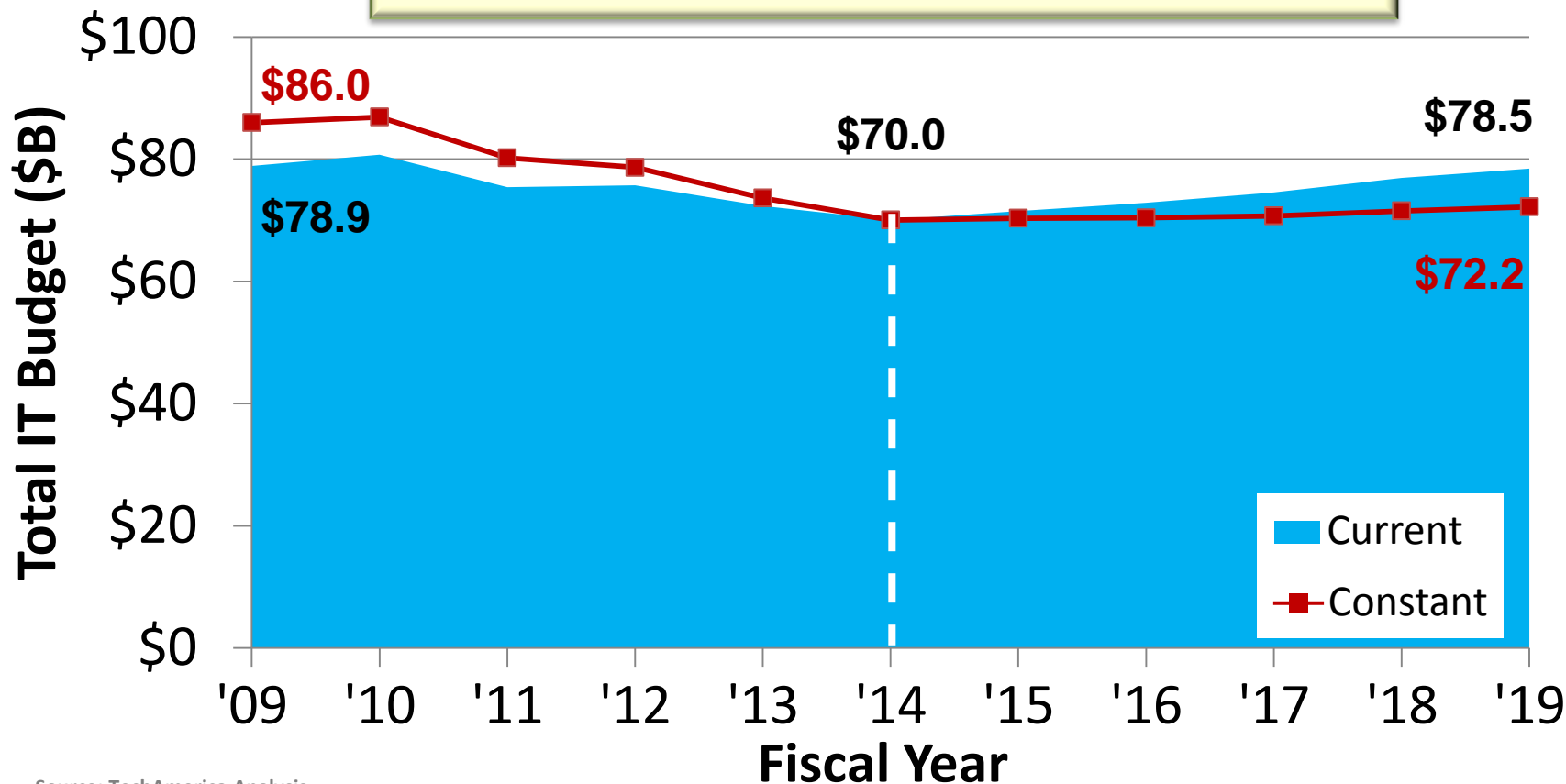
Top 3 Issues

	Issues	Examples
Budget Challenges	Sequestration / Debt Ceiling / Entitlements	Looming cuts; \$17T national debt; Expansive entitlement growth
	Political gridlock impacting public and private sectors	\$3T corporate cash; ~\$2.1T excess bank reserves ; Regulation uncertainty
Government Transformation	Transformation	FITARA; Sequester impacts transformations CIOs taking back seat to Pres. Agenda
	Technology Shift	Consolidation not replacing legacy fast enough; new tech rapidly evolving
	Workforce challenges	Retirements, pay freeze, training, talent retention
Cyber	Leadership	Who leads? White House, NSA, DHS, DOD?
	Tech Advancements increase privacy concerns	PII, data aggregation; Credit card transaction monitoring; perception vs. reality

Opportunities found in addressing top issues

Total IT Market Forecast FY14-19

	FY09-FY14	FY14-FY19
CAGR Current \$	-0.8%	2.3%
CAGR Constant \$	-2.8%	0.6%

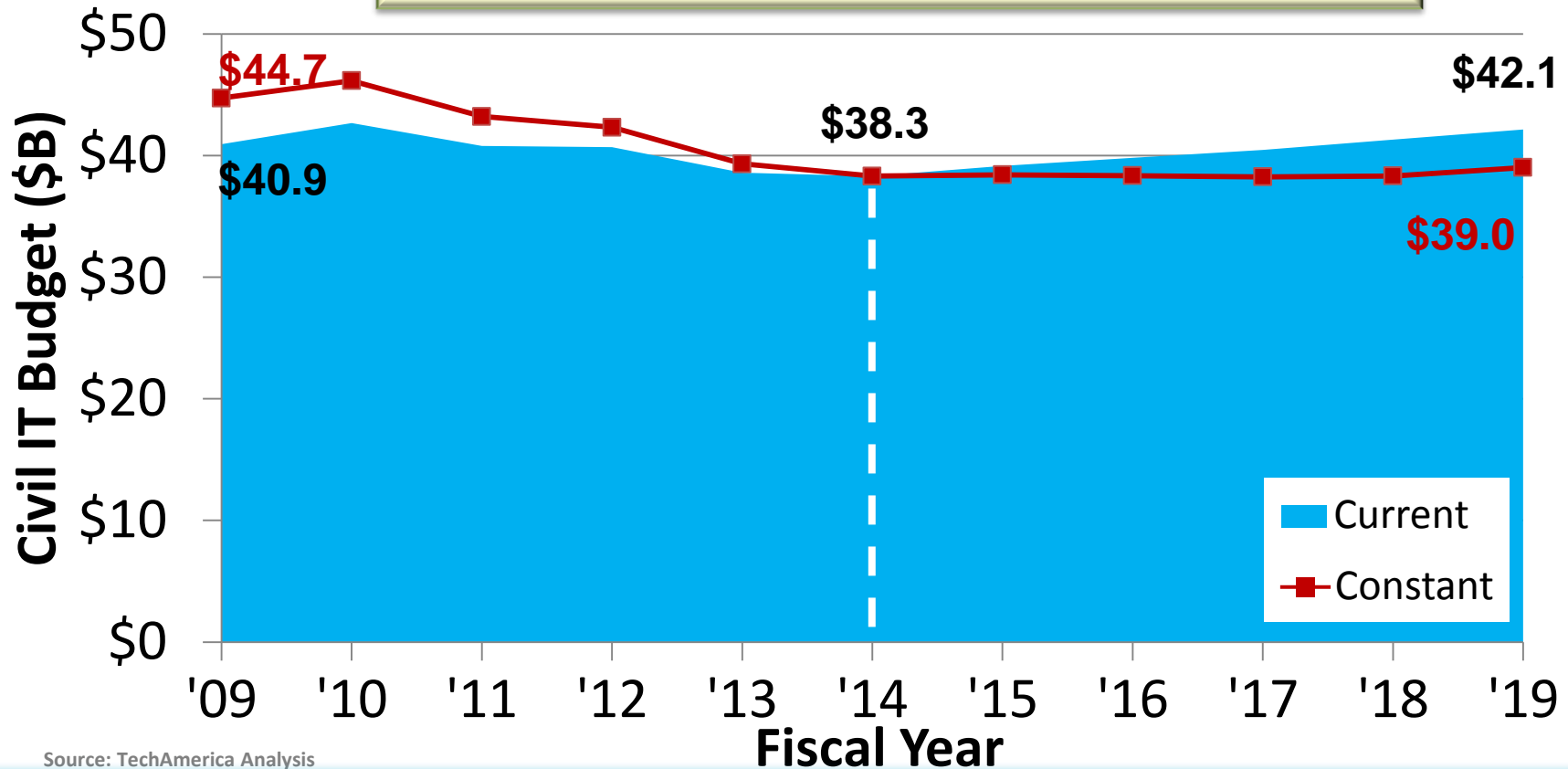


Source: TechAmerica Analysis

Sequestration pressures near term IT Market

Civil IT Market Forecast FY14-FY19

	FY09-FY14	FY14-FY19
CAGR Current \$	-1.3%	1.9%
CAGR Constant \$	-3.1%	0.4%



Source: TechAmerica Analysis

Civil IT budget is flat in near term but grows with discretionary spend

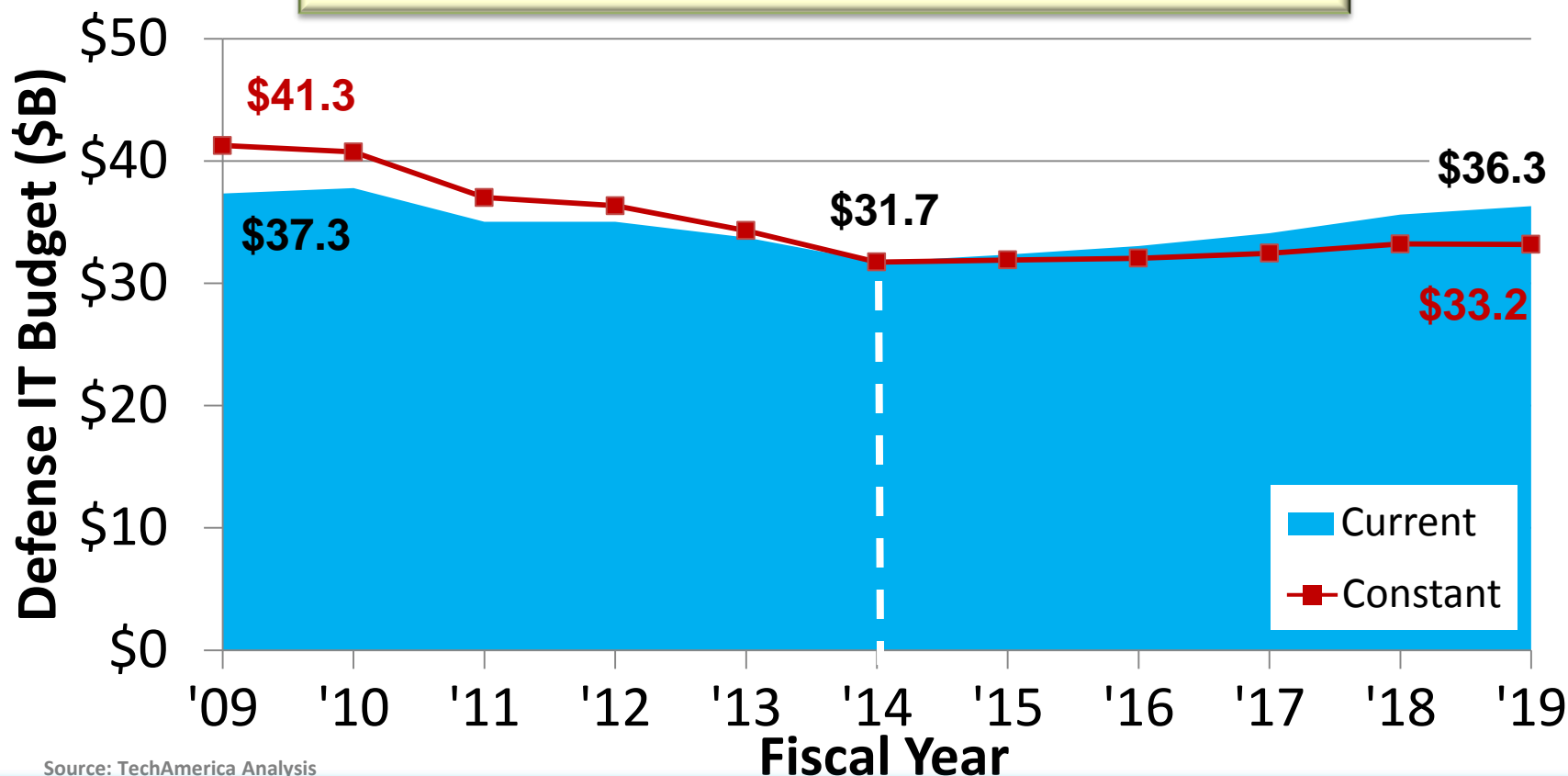
Civil Forecast Comments

- **Cost savings continues to be a high priority as spending is shifted between different investment areas**
- **LPTA: Budget constraints are forcing agencies to limit extras and focus on IT as a commodity**
- **Innovation cannibalizes budget from legacy systems**
- **Budget uncertainty constraining technology migration**
- **Cybersecurity continues to challenge agencies**
- **Security issues slowing adoption of new technologies**

Civil agencies seek solutions that quickly cut costs & improve operations

Defense IT Market Forecast FY14-FY19

	FY09-FY14	FY14-FY19
CAGR Current \$	-3.2%	2.7%
CAGR Constant \$	-5.1%	0.9%



Source: TechAmerica Analysis

DOD IT budget faces near term pressure with inflation level increases at end of forecast period

DoD Forecast Comments

- O&M shortfall caused by OCO may impact IT
- End strength reductions will impact IT usage
- Joint Information Environment offers opportunities, but requires further definition
- Open systems used to reduce software spend
- Cyber security remains a high priority; some areas are commoditizing
- Security issues & fears inhibiting new tech adoption – cloud, mobility, info sharing
- Furloughs delaying contract releases
- LPTA is preferred contract type

“The industrial base would be making a mistake to think that our industry is immune to other economic issues.” – Interviewee

Emerging Opportunity Areas

■ Consolidation / Transformation

- Strategic sourcing / consolidation still strong
- Datacenter consolidation progress uneven; good opportunities exist
- IT refreshes increasingly important after being postponed

■ Big Data

- Data driven government transformation
- Generate value from government data: healthcare, research, security, etc.

■ Mobile / End User Access / Wireless

- Bring Your Own Device challenges include “hidden” costs
- Legacy back end systems required to support mobile apps development
- Innovation needed to control and manage data portability across devices

■ Cybersecurity

- Threatscape continues to evolve unabated; Advanced Persistent Threats
- Support structures to get basics right; Opportunity beyond basics

■ Training

- Cost effective training – virtual, self-service, etc.; mission & technical

Smaller, shorter contracts often characterize emerging opportunities

Summary

- **Expect lag & burst procurement cycles**
 - Uncertainty over budgets, sequestration and other fiscal issues
 - Deal FY timing & uncertainty will influence business cycles
- **Transformations have had mixed results**
 - Good start on savings and reducing duplication
 - Challenged to define whole problem (How much IT? Where? Owner?)
 - Lack of consistent metrics to measure success
 - Leadership & vacancies / financial challenges stalling progress
- **Policy priorities likely to supersede IT decisions**
 - Consolidation impeded as management attention focused elsewhere
 - May accelerate waning CIO influence; FITARA could change this

Solutions with immediate cost savings are likely to win