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REPORT TO THE CONGRESS

Implementation Of Emergency Loan Guarantee Act

B-169300

Lockheed Aircraft Corporation
Emergency Loan Guarantee Board

BY THE COMPTROLLER GENERAL OF THE UNITED STATES

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APRIL 22, 1974

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-169300

To the President of the Senate and the
Speaker of the House of Representatives

This is our third report on activities of the Lockheed Aircraft Corporation, Burbank, California, the only business to apply for a guaranteed loan under the Emergency Loan Guarantee Act, 1971 (15 U.S.C. 1841, supp. I, 1971). The law established the Emergency Loan Guarantee Board to administer loans in amounts up to but not exceeding $250 million.

We have been making reviews pursuant to the Emergency Loan Guarantee Act; the Budget and Accounting Act, 1921 (31 U.S.C. 53); and the Accounting and Auditing Act of 1950 (31 U.S.C. 67). This report has been prompted by recent events which required a reevaluation of Lockheed's ability to repay its Government-guaranteed borrowings within the time frame scheduled in the credit agreement between the company and the lending banks.

Our review involved:

--Reviewing corporate actions which affected Lockheed's financial structure.

--Examining the bases for Lockheed's forecasts of cash flow and revenues, including those from the Department of Defense, and comparing these forecasts with actual transactions.

--Making necessary tests of the accounting records and major cash transfers and expenditures.

The examination of Lockheed by its independent external auditors for the calendar year 1973 had not been completed at the time of our review (February 1974).

The emergency loan guarantee fund, accumulated from guarantee fees and commitment fees paid by Lockheed and from interest on Treasury bills, totaled $7,282,133 as of December 31, 1973, after deduction of expenses of $337,772. Of this amount, $6,047,616 was invested in Treasury bills. The fund is available to the Emergency Loan Guarantee Board to pay expenses and to fulfill its obligations.

Our prior report (B-169300, Aug. 13, 1973) indicated that Lockheed was restructuring production processes to reduce costs and improve the delivery schedule of its L-1011 commercial aircraft (TriStar) and that new top management personnel had been designated to monitor the progress of the TriStar program. Nevertheless, costs of producing each succeeding aircraft have not decreased as forecast. In addition, reductions in deliveries scheduled and anticipated during 1974 and 1975 have decreased the company's expected sales revenues and have required Lockheed to stretch out production of the aircraft. Also, changes in Department of Defense regulations on pension plan funding and the withholding of receipts anticipated from settlements on ship claims have increased the company's cash requirement.

These circumstances have resulted in a revision of Lockheed's financial forecast. Experience has shown that prior forecasts of L-1011 costs were optimistic. Considering its corporatewide activities, the company has announced its need to defer the 1975 date for completion of repayment of guaranteed loans, established in its loan credit agreement, into 1977. The company has initiated action to arrange for this deferment. Although Lockheed had forecast in 1971 that it would need only $150 million of guaranteed loans, its requirements have steadily increased to the extent that it says it expects to borrow the total of $250 million authorized under the Emergency Loan Guarantee Act.

FINANCIAL OUTLOOK

Lockheed's ability to carry on as a viable concern depends on the achievement of goals outlined in its latest forecast, particularly those of the L-1011 TriStar program. Although the program does not represent the major source of Lockheed's corporate revenue, the company's dominant investment in developing and manufacturing this aircraft has been the principal reason for its unusual need for working capital. Attainment of the program goals, however, may be influenced by economic and energy supply factors not fully predictable by the company.

Although sales to the Government have been the mainstay of Lockheed's business in the past and continue to represent the largest percentage of income sources, they are no longer such a dominant factor in the company's sales. About 60 percent of Lockheed's 1973 sales of $2.8 billion were Government sales compared with 74 percent of 1972 total sales of $2.5 billion. The TriStar program, which accounted for 27 percent of 1973 sales (12 percent in 1972), is playing an ever-increasing role in, and is vital to, Lockheed's financial stability.

TriStar inventories represented $1.2 billion, or 75 percent of the corporation's current assets of $1.6 billion at the close of 1973. Until a substantial portion of this inventory is liquidated through sales and deliveries of completed aircraft, Lockheed will have an abnormal need for cash to service its heavy debt load. For example, the company disbursed about $60 million in interest in 1973 and expects to disburse $76 million in 1974. A significant deviation from the projected near-term costs for the L-1011 program would most likely require additional financing beyond that contemplated. The availability of such additional financing is not insured.

Lockheed management is emphasizing the elimination of all nonessential expenditures, particularly in overhead or service functions, and is taking measures which it expects will reduce administrative costs and improve the company's cash position.

For example, at the corporate office level, Lockheed has dropped 38 personnel and has made other cutbacks for an expected annual administrative cost savings of about $3.2 million. Also, about 6,000 personnel have been dropped at the company division responsible for TriStar production. Administrative cost savings at the division level could not be measured since the number of those employees who had performed service or administrative functions was not readily available.

In addition, Lockheed has restricted fixed asset acquisitions to essential requirements to delay cash outlays and benefit the company's near-term cash position. According to management, it expects to limit fixed asset acquisitions to items that are mandatory for current programs and to continue to dispose of unneeded facilities and equipment. The division plans to reduce cash outlays for general and administrative activities, nonessential repairs and maintenance, and independent research and development.

LOCKHEED'S CASH REQUIREMENTS

In its financial forecast of February 1973, Lockheed estimated that its Government-guaranteed loan would be fully repaid by the end of 1975, as specified by its credit agreement with the lending banks. The February projection also estimated that its guaranteed borrowings would peak at $210 million. This figure, Lockheed officials had informed us, included a $30 million cash reserve for unforeseen contingencies.

The contingencies provided for in February 1973 had not only taken form within 10 months of that forecast but seriously affected Lockheed's near- and long-term cash position. In its most recent forecast in December 1973, the company indicated it might borrow up to the full amount of the $250 million authorization provided by the Emergency Loan Guarantee Act and it might not be able to repay its guaranteed loans before the end of 1977.

Section 4(b) of the act (15 U.S.C. 1843) provides that guaranteed loans be repaid within 5 years but permits renewals for periods of up to 3 years. Consequently, the 2-year repayment delay, which will require approval by the Emergency Loan Guarantee Board, is not contrary to the law.

Lockheed is negotiating[1] with its lending banks for additional credit of up to $75 million to be drawn on as may be needed primarily to tide the company over periods between completion and delivery of L-1011 TriStars during 1974 and 1975. The completed or nearly completed aircraft will be security for short-term loans, if needed, and the Board must approve this arrangement.

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[1] In March 1974 Lockheed reached an agreement with its lending banks for additional credit of up to $75 million.

At the end of February 1974, Lockheed's overall bank borrowings totaled $620 million; $220 million was guaranteed by the Government. The credit agreement covering the company's bank loans established a debt ceiling at $595 million from December 31, 1973, through December 30, 1974. The Board and the lending banks consented to the excess of the $25 million.

Lockheed, in seeking a more permanent solution to its cash needs, is exploring the possibility of merging with another company. The firm, Lazard Freres and Company, an investment banking house, has been engaged to discuss merger prospects with interested parties.

FACTORS CONTRIBUTING TO LOCKHEED'S FINANCIAL DIFFICULTIES

A major part of Lockheed's current financial difficulties has stemmed from higher than anticipated production costs for L-1011s. Another factor adversely affecting Lockheed's near-term cash outlook has been a reduction in the L-1011s projected for delivery during 1974 and 1975. According to its February 1973 forecast, the company had expected to deliver 22 more TriStars during 1974 and 1975 than indicated in its December 1973 forecast. Delivery of the 22 aircraft will be in later years.

L-1011 production costs

According to our previous report, projected L-1011 costs had been sizably increased and the manufacturing learning rate had not been realized to the extent anticipated. For a time during 1973, aircraft production hours and costs showed a favorable downward trend. However, production costs again began to exceed the company's projections during the latter half of the year. As a result, Lockheed has again increased its estimate of the total projected L-1011 program costs in its latest forecast.

The company's inability to meet the projected learning rate became manifest in late 1973--the second full year of L-1011 production. For example, projected direct labor hours for 1973 were overrun by 10 percent and direct labor costs exceeded Lockheed's estimate by 7 percent.

The company has attributed its higher TriStar production costs to (1) difficulties in achieving an increased production schedule during 1973, (2) new customer requirements, (3) special modification programs, (4) inability to achieve its expected learning rate because of manpower turnover, and (5) stretchout of production into the future.

Cash flow from operating earnings

Lockheed's reported combined operational earnings for the last 3 years on its other programs, though higher than forecast, have been insufficient to supply the needed working capital for the TriStar program. At the end of February 1974,[1] Lockheed held 199 orders for L-1011 aircraft; 70 were for optional "second buys" to be exercised by customers from 1975 through 1980. Deliveries of the 129 firm orders are scheduled to be completed by 1976.

In the unlikely event that none of the options are exercised, the corporation stands to suffer a loss on the L-1011 TriStar program which could not be absorbed through the combined profitable operations now forecast by Lockheed through 1977 from its subsidiaries and divisions. According to Lockheed management, a potential market of over 300 L-1011 aircraft extends into the 1980s and such a program should recover the investment in L-1011 inventory. If the number of aircraft to be delivered is overestimated or future costs are underestimated, substantial losses in subsequent years could result.

Lockheed has firm orders for 129 L-1011 aircraft and optional orders for 38 which collectively are planned for delivery through 1977. Lockheed's customers have indicated generally that they plan to exercise these options. We have found no basis for questioning Lockheed's forecast that 38 optional aircraft orders will be delivered through 1977. If these firm and optional orders are delivered through 1977 as projected, current data indicates that sufficient cash would be available to liquidate guaranteed loans up to $250 million and other corporate debt requirements.

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[1]In March 1974 optional orders for 3 aircraft were not exercised; however, Lockheed received additional orders for 6 aircraft resulting in total orders for 202 aircraft.

The observations set forth above consider all the premises shown in Lockheed's most recent financial forecast. Therefore, the company must substantially achieve all of its projected forecast premises and goals, including the realization of additional L-1011 firm orders through converting current second-buy orders and additional new sales to insure its continued viability.

CORPORATE FORECAST OF 5-YEAR PROFITS

Lockheed has currently projected operating profits--for the 1974-78 period--sufficient to maintain the company's stability and generate sufficient funds to liquidate its Government-guaranteed loan by the end of 1977. This forecast, however, presumes deliveries of more than 200 TriStars, including aircraft which have not yet been ordered, in addition to other corporate business.

The company's prediction of unordered TriStars has been based on the company's market analysis of future requirements for wide-bodied commercial passenger aircraft. It must be recognized that the uncertainties presented by general economic conditions and energy problems make long-range forecasting of limited value.

Lockheed has, for the time being, delayed plans to develop and market an extended range TriStar (L-1011-2). It is considering two modifications of the basic L-1011 with some comparatively minor structural changes, including, in one version, the incorporation of additional fuel capacity within the center portion of the wing. These changes, in one case, will add 500 and in the other from 900 to 1,000 nautical miles to the basic 3,000-mile range of the aircraft.

The modified TriStars, both improved basic L-1011s, will be able to carry 273 passengers and baggage nonstop from New York to London or Paris and from Montreal to Paris. According to Lockheed officials, certain L-1011 customers are interested in the proposed modified models. A kit to modify existing L-1011s would also be made available.

We are sending copies of this report to the Director, Office of Management and Budget, and to the Chairman, Emergency Loan Guarantee Board.

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Comptroller General
of the United States

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