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Aviation giant forced to shift gears

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future of Rockwell Collins: Clay Jones, Chairman, Pres. and CEO of Rockwell Collins, talks about the company

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Written by ADAM BELZ

CEDAR RAPIDS, IA. — Two stories are playing out in Cedar Rapids.

One is the city's lavish flood recovery, which is paying for a slew of new buildings in the city's center and creating jobs along the way. The other is Rockwell Collins, the most valuable publicly traded company in Iowa, which builds and sells aviation electronics, a business that's been diminished by cuts in defense spending and the wind down of the wars in Afghanistan and Iraq.

Federal flood relief, grants and tens of millions of local dollars are fueling a furious comeback for Iowa's second-largest city. The flood has ironically gifted the town with an unrivaled economic stimulus package, and most of the downtown hums, beeps and thunders

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Clayton M. Jones, chairman, president and chief executive officer of Rockwell Collins in Cedar Rapids, discusses the company and its future. / RODNEY WHITE/THE REGISTER



Rockwell Collins's Joel Conrad, left, and David Leedom demonstrate a touchscreen navigation interface at the company's Customer Experience Center in Cedar Rapids. Collins is focusing on its commercial and international business as defense contracts dry up due to the military cutbacks. / RODNEY WHITE/THE REGISTER

with the work that money has paid for.

But the federal government gives, and it also takes away. One of the few pieces of troubling economic news in Cedar Rapids is that Rockwell Collins' stock price is in a two-year post-recession slump.

Rockwell Collins is still very profitable — \$634 million in 2011 — but a military scale back is forcing the company to shift from building avionics for the Pentagon to focusing on its commercial and international businesses, each of which presents its own challenges.

It's difficult to overestimate what Rockwell Collins means to Cedar Rapids. The company, the city's largest private employer, has 8,700 people working here, and several hundred more in Coralville and Manchester. Roughly half of the employees in Cedar Rapids own a home, the city estimates, and they earn, on average, \$65,000 per year.

Rockwell Collins has 800 suppliers in Iowa, and estimates its annual economic impact in the state is \$3.2 billion. The city estimates the company indirectly creates an additional 10,300 jobs.

Downtown Cedar Rapids and Rockwell Collins are like cousins — related but not intimate. The company has its own orbit in northeast Cedar Rapids. Its 250 acres of design laboratories, manufacturing lines and broad green lawns dominate this fast-growing portion of the city, feeding growth in the suburbs of Hiawatha, Robins and Marion.

Wiring the military's giants

Engineers stand around mock cockpits in a building on the west end of Rockwell's campus, typing on computers and testing controls, building avionics for the military planes that either transport cargo or refuel other planes.



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It's a market Rockwell dominates. Over the past decade, new Rockwell Collins avionics have been installed in more than 400 KC-135s, the Korean War-era tankers still used by the Air Force. Rockwell has upgraded avionics on 150 C-130 transports across the world. Upgrades for the more recent KC-10 will begin later this year. Rockwell will also, thanks to Boeing's success winning the latest contract, build the avionics for the newest generation of tankers, the KC-46.

Matt Wietlispach climbed into the cockpit of an old Continental DC-10. He had the jetliner's nose delivered to Cedar Rapids on a flatbed truck from Mojave, Calif., in 2006.

Once engineers began designing the new KC-10 avionics, they started using the DC-10 nose as a dummy for testing. Wietlispach wanted it to look like an Air Force tanker inside and out, so he painted it.

"I swear, military gray is the same as Martha Stewart's Black Pearl," Wietlispach said. "So I just ordered two cans of that and a roller, and changed it from Continental colors to Air Force."

Engineers wire the nose of the plane exactly as they would a KC-10, and then test the cockpit to make sure all the controls and wiring fit together. Later they will train pilots in it. The system will be installed on KC-10s starting in November.

"Other contractors have tried to do it without getting a nose section and found out at the last minute that their stuff won't fit," Wietlispach said.

Wietlispach is not the boss, but he has the run of the tanker/transport department. He writes proposals, runs tests, works on bids, and now he's building and testing avionics on the KC-10. He is passionate about avionics and Rockwell Collins. His grandmother worked for the company for 40 years, and though he grew up near Chicago, he said he always wanted to work for the Cedar Rapids company.

In his spare time, he works on a fighter plane flight simulator in his Cedar Rapids basement made of F-15, F-16, F-18 and A-10 parts that he calls a "FrankenSim." He can fly it through the virtual streets of Chicago or Paris at twice the speed of sound. He also has a fully-outfitted Boeing 747 cockpit in his garage.

In a world where most consumer electronics are obsolete within two or three years, Wietlispach, 46, gets to build machines that will probably work long after he retires. The KC-135 avionics system must be able to withstand desert heat even though the old planes don't have air conditioning. The controls will get so hot pilots will need gloves to touch them, but they can't fail.

"We're not talking about throwaway electronics here," Wietlispach said. "We're talking about stuff that you design and build and people are going to use for decades."

Defense cuts create chill

Despite the success of the tanker transport division, Rockwell Collins has a problem: The U.S. military is building fewer war planes and helicopters, and further defense cuts are possible.

Congress and the White House agreed in August to across-the-board spending cuts that would remove \$1.2 trillion from the country's defense budget over the next 10 years. These cuts, unless revisited by Congress, would go into effect Jan. 1, 2013.

"This is undoubtedly the single worst piece of public policy I have seen in my 32 years in the industry," said Clay Jones, chief executive of Rockwell Collins.

He thinks the \$1.2 trillion cuts, known as sequestration, would disrupt contracts and supply chains across the defense industry. He also thinks they likely won't go into effect because Congress will act. But declining defense spending has already eaten into a government division that for years has been Rockwell Collins' flagship business.

Government sales fell 2 percent in fiscal 2011, which ended in September. The division's sales have fallen another 11 percent in the first half of 2012.

"It's no longer the same fantastic boom market that defense companies enjoyed over the past seven or eight years," said Richard Aboulafia, vice president of analysis for the Teal Group, an aerospace and defense intelligence firm based in Fairfax, Va.

Sequestration would be an even more severe blow. Even if Congress revisits the issue, the possibility could hang over defense companies indefinitely, Aboulafia said, and Rockwell Collins itself flagged "political volatility" as a risk factor in its annual report.

"You kick the can down the road, which means the threat remains," Aboulafia said. "The threat's going to be hanging over our heads longer than anybody likes, and that sends a chill through the industry."

Rockwell's stock price has accordingly suffered. Shares have dropped about 14 percent in the past two years, while competitors Honeywell and Garmin are up 30 percent and 28 percent respectively, and the broad Standard & Poor's index is up 20 percent.

Analysts say comparing those stock prices isn't quite fair. Garmin makes money by selling consumer products like car navigation systems. Honeywell makes money in all kinds of businesses, including commercial airliners. And neither Garmin nor Honeywell is as focused on defense contracts as Rockwell Collins.

The stock price does highlight, however, how the businesses Rockwell Collins depends on most — defense contracts and business jets — are the most troubled markets in avionics.

Commercial market growing

Rockwell Collins is run mostly by engineers and former military officers. Jones, 60, was a fighter pilot in the Air Force through the

1970s.

He's put together like a CEO from central casting — tall, trim, a gentle Southern accent, perfect manners, sandy gray hair and deep cracks in his cheeks that catch the corners of his smile. When he makes a point, he shifts to the edge of his chair, raises himself forward and slices the air with his hands.

"What we're seeing today is a government market tipping over for the first time in about eight years, and a commercial market that's recovering," Jones said.

Rockwell Collins' commercial sales — which were about two-fifths of the company's total revenue in 2011 — rose 13 percent despite the weak economy, to \$2 billion, and have risen in the first two quarters of 2012 by 9.4 percent compared with last year.

The company builds or will build avionics for passenger jets like the Boeing 787 Dreamliner and 747-8, French Airbus A350, Russian Irkut MC-21 and the Chinese ARJ21 and Comac C919. Rockwell Collins has also sold its newest avionics system, the Pro Line Fusion, to Japanese Mitsubishi, Canadian Bombardier, Gulfstream American and Brazilian Embraer airplane manufacturers.

"Collins' market share has actually expanded," said Sam Pearlstein, senior aerospace and defense analyst for Wells Fargo Securities. "They've actually been very competitive, and have had some pretty substantial wins."

Fewer buying corporate jets
Commercial sales aren't rising as fast as government sales are falling.

Rockwell Collins' strongest commercial business has historically been regional commercial airplanes and the corporate jets sold by companies like Bombardier and Gulfstream, said Abouafia, the Teal Group analyst.

A four-passenger Gulfstream G150, which boasts a Rockwell Collins avionics system, costs \$15 million. People don't buy these planes unless they're confident about the economy. While airline orders for Boeing and Airbus passenger jets rose quickly over the past two years, the business jet market has been more sluggish. "That market is slow to recover," Aboulafia said.

International business accounted for 30 percent of Rockwell Collins' sales in 2011, but Jones wants it to be 40 percent by 2020. In 2011, Rockwell opened offices in Brazil, China, Russia, India and the United Arab Emirates.

"Although we're projecting flat or declining budgets in the U.S., we're actually projecting growth in the rest of the world, because a lot of these countries live in really bad neighborhoods," Jones said.

He's thinking of India, Turkey, the Middle East, Brazil and South Korea. They are growing economically, and want to be players on the world stage.

"Part of the way you do that, to exert your capabilities in foreign policy, is to have a strong military that you can use not only to protect your own borders, but to help your allies and neighbors when they are in duress," Jones said.

Making money selling avionics to these governments is more difficult than working with the U.S. government, however, said Aboulafia. The Pentagon wants to support U.S. defense companies like Rockwell Collins, so it awards contracts that guarantee a certain amount of profit. Foreign governments make no such guarantee.

"Saudi Arabia, what do they care about the health of the U.S. defense industrial base?" Aboulafia said. "They're interested in getting good value for the money."

Jones, who turned 63 in April, said running Rockwell Collins has been one of the great privileges of his life.

“I would say I spend no time worrying about my legacy,” he said. “The only thing I hope is that I can move the company forward. It’s been around 77 years. It was here before I was here, it’s going to be here long after I’m here.

“I just hope I’ve made more good decisions than bad, and leave it better than I found it,” he said. “If I have done that, then I will feel good about my tenure.”

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Rick Johnson of Rockwell Collins operates the touch screens used in military and commercial avionics. / RODNEY WHITE/THE REGISTER



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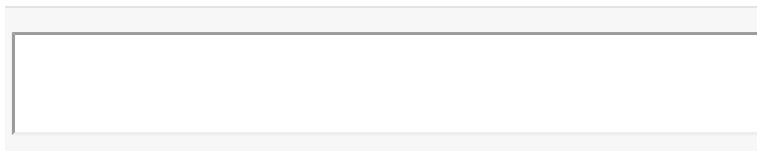
Rockwell Collins employees Matt Wietlispach, left, and Joseph Rohret work on a simulator for testing an upgrade for tanker controls. / RODNEY WHITE/THE REGISTER

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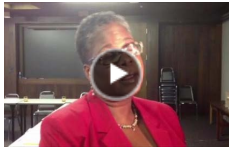
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