



White Paper

Status at the end of 2006 of LHBw's work to meet the contractual specifications of its contracting party, the German government and Ministry of Defense

LHBw is a joint venture between the **German Government** and **Lion Apparel** and **Hellmann Worldwide Logistics**, formed in 2002 at the outset of the conclusion of a competition to outsource the management of German Military Clothing. LHBw's corporate purpose is the execution of procurement and distribution measures and the provision of services in connection with ensuring supply of the soldiers and civilian employees of the German Armed Forces with clothing and equipment.

According to the contractual agreements between the German government/Ministry of Defense and LHBw, the main responsibility of LHBw is to improve service quality relative to the actual status (2001) at the time the agreements were concluded (August 2002) and to cut the costs of managing the army's clothing operation. To this end, LHBw is required to ensure timely and adequate supply of soldiers and civilian employees and meet the minimum qualitative standards.

LHBw has met the aforementioned requirements for a total of 4 years of the contractual term, without exception, and has exceeded requirements in the essential aspects of the agreement listed below:

Procurement of articles and services

Even with the application of the Rules for the Award of Service Contracts, LHBw has been able to meet and clearly exceed the contractually guaranteed 8% price reduction, to the advantage of the German government:

Period	Required	Actual
08/2002 to 10/2003	4 %	21 %
11/2003 to 10/2004	8 %	17 %
11/2004 to 07/2005	8 %	19 %

The price reductions for the period August 2005 to July 2006 are still under consideration, but they will certainly exceed the required 8% reduction and will be in the range of the actual reductions mentioned above.

Actual procurement expenditures were lower than the original forecast in the period from 2002 to 31 July 2006, as follows:

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Total procurement

Estimated	Actual	Difference
277 Mio. Euro	184 Mio. Euro	- 93 Mio. Euro

Thus, actual procurement expenditures were about 33% lower than the German government's 2002 forecast even though LHBw has to spend about EUR 52 million in unplanned procurement expenditures for special service uniforms, protective vests and NRF inventories.

Reduction in personnel expenses

Overall, the staff adjustment has been faster than expected. LHBw already performs its contractual services as part of the new clothing management system with about 1,400 fewer employees, an average of about 450 per year, than it had originally assumed at the beginning of the term and in the profitability estimates. See the table below:

	Period				
	mid 2002	2003	2004	2005	2006
contractual estimate	(3155)				
average (estimated)	3074	2873	2662	2448	2271
average (actual)	2621	2475	2340	1897	1709

Difference	(- 534)	- 398	- 322	- 551	- 562

Reduction of inventories

The Bundeswehr's stocks have been reduced from EUR 625 million to about EUR 295 million by mid-2006. This reduced amount, EUR 295 million, includes about EUR 40 million for the unplanned procurement of special clothing.

IT support

By the end of 2003, LHBw had installed a complete new IT system (hardware and software) with the latest Oracle software components in all Bundeswehr clothing facilities. The Oracle components were combined in targeted fashion with various specialized applications from other software providers. For example, a state-of-the-art barcode system was introduced throughout the company in January 2004 to record transactions. This system allows the company to maintain a personal clothing account for each new soldier which is updated with each transaction (documentation for the wearer and LHBw).

The IT system is the culmination of all changes, process optimizations and rationalizations made by LHBw to the Bundeswehr's clothing operation since 2002.



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If such an IT system had not been introduced, LHBw would not have been able to exceed the tremendous cost reduction targets forecast and contractually guaranteed by Lion and Hellmann in 2002 and to improve service in the Bundeswehr's clothing operation.

Location-based service

LHBw reduced the number of service stations from an original 171 to 111. Together with the closure of a number of former temporary storage facilities, this has led to a significant decrease in storage space and pallet parking spaces.

Location-based service has improved substantially under the direction of LHBw, especially with regard to the supply of about 20,000 recruits with clothing each quarter, despite the reduction in Bundeswehr inventories by half and a decrease in the number of Bundeswehr employees by 1,446, from an original 3,155 to 1,709. The service level of this recruit outfitting has on average been greater than 98%.

Subsequent integration of supply rooms into the service range of LHBw

At the specific request of the Inspector General and Defense Administration Office, LHBw has developed a new concept to replace the current 242 supply rooms on military bases.

The supply rooms were not originally part of the Bundeswehr's clothing operation. In the future, based on LHBw's new concept, the troops will be supplied through the service stations. The former supply rooms will be largely eliminated. This will lead to another major reduction in costs for the German government, for a one-time sum of about EUR 20 million, since it will no longer be necessary to procure equipment. In addition, about EUR 12 million in costs will be saved each year.

Incentive Revenue as a Result of LHBw Performance

In the original contract with the German Government, the government established four categories of incentive targets. Achieving cost or product savings in each of these four areas results in LHBw being awarded a portion of savings or process cost improvement from these changes.

Below is a chart that indicates how the incentive sharing for the three most important were defined, and below that chart is the actual revenue received by LHBw as a result of its realizing costs savings between 2002-2006.

Cost Reduction Sharing percentages	Bundeswehr	LHBw
Process Optimization	50%	50%
Purchasing Price Reduction	30%	70%
Washing and Repair Cost Reduction	50%	50%

Total: Incentive Revenue from 2002-2006 - Euros	€7,910,258
Process Optimization	993,413
Purchasing Price Reduction	5,856,951
Washing and Repair Cost Reduction	360,000

Conclusions From The First Four Years Of The LHBw Contract

The project has created very large financial savings for the German Government and so far has met all of its key performance targets:

- € 20.0 million in one time cost reduction
- € 12.0 million in annual costs of operation
- €330.0 million of inventory reduction
- 98% + on Time Service Delivery Level for the Quarterly Supply of New Recruits