

ALASKA AEROSPACE CORPORATION

Senate Finance Committee Testimony

Thursday March 18, 2016

Madam Chair;

Thank you for allowing me this time to present an update on Alaska Aerospace Corporation (AAC) activities this past year. Because I have to do this via teleconference, I have provided a written copy of my testimony for your convenience.

THIS IS A GOOD OPPORTUNITY TO PUT FACTS ON THE RECORD CONCERNING ALASKA AEROSPACE TO COUNTER MUCH OF THE MISINFORMATION THAT HAS BEEN PRESENTED BY DETRACTORS DURING PUBLIC TESTIMONY AND EVEN FROM SOME LEGISLATORS DURING COMMITTEE AND FLOOR SESSIONS.

Alaska Aerospace Corporation is currently a state-owned corporation established by the legislature in state statute. AAC is the only government or private sector company in the state that provides the services and capabilities for space launch and aerospace development. The University of Alaska also has a very active aviation education curriculum at the University of Alaska- Anchorage, and the University of Alaska – Fairbanks operates the Poker Flat launch facility and a satellite downlink operation under the Geophysical Institute. The Poker Flat launch site is primarily funded by NASA for sub-orbital studies of the aurora.

AAC is exempt from many state department regulations, requirements, and the state procurement code, but remain under the state Department of Military and Veterans Affairs for administrative oversight only. As part of our existence, the legislature provided, in statute, that AAC has bonding authority. However, we have never utilized that capability. Therefore, we have no outstanding debt or current liabilities.

But AAC is not the same company that came before you in February 2015. Much has happened to move the company away from state dependency into a true commercial marketplace. At a time when oil and gas prices are at damagingly low values for our state, at a time when there is tremendous pressure on our state budget to support the essential services Alaskans expect from government, I am pleased to be here to give you a positive story about our/your aerospace company that demonstrates our success at no longer being dependent on state funding, while creating a resurgence in aerospace business for our company.

But first I would like to set the stage for my presentation. Historically, Alaska Aerospace Corporation has been solely viewed as the Kodiak Launch Complex. Measurement of our success was based on the number of launches from Kodiak and the revenues generated by those launches. While that model proved successful for many years, the past five years have shown that Alaska Aerospace can no longer be a successful company by rocket launches from Kodiak alone. Let me explain.

From 1996 until 2011, AAC did not require any state funding for Operations and Sustainment. The company operated within the revenues received from launches at Kodiak. During that period, AAC successfully launched 16 rockets, all for the Federal government. However, as the Federal

government changed focus on missions, the lucrative government contracts that AAC had relied upon quickly came to an end. With no other business units within the company, the future financial position of AAC quickly became a serious issue. In 2011, my predecessor requested \$4.0 million in the governor's budget which the Legislature approved to support the daily Operations and Sustainment of AAC until such time as we could secure more launches. In SY 2012, AAC again requested and received an additional \$4.0 million in General Funds for Operations and Sustainment. This was followed in SY 2013 by a request for \$8.0 million, which was also approved.

In October 2012, I was appointed as the new President and Chief Executive Officer for AAC. During my subsequent presentations before both the House and Senate Finance Committees, I made the pledge that AAC would become a profitable company, that we would diversify, and that we would implement a long term budget plan to reduce state general funds for Operations and Sustainment by \$2.0 million per year. The SY 2014 budget contained the final \$8.0 million request, with our SY 2015 budget request reduced to \$6.0 million and our SY 2016 budget request targeted for \$4.0 million.

In addition to the Operations and Sustainment funds, AAC also requested \$25.0 million in SY 2013 to pursue medium-lift expansion capabilities at Kodiak. The Legislature passed this capital fund appropriation, with a specific expenditure plan which stated that AAC could spend an initial \$3.0 million for engineering, environment, permitting, and associated preparatory efforts. Once a contract was secured, AAC could expend an additional \$10.0 million on site development work to support the expansion

program. However, the remaining \$12.0 million could not be spent until all additional financing for full construction of the medium-lift facilities, known as Launch Pad 3, had been secured.

In 2014, AAC initiated the engineering and environment processes. Later that year, AAC awarded to Lockheed Martin the right to proceed with medium-lift development for the Athena IIS, provided they secured a launch customer for the vehicle.

Following the election of Governor Walker and in light of the State's fiscal situation, Governor Walker issued Administrative Order 271 in December 2014 halting discretionary spending on mega projects. AAC immediately ceased all work on the Kodiak Launch Complex medium lift project.

Unfortunately, Lockheed Martin was not able to close the business case on the Athena IIS, so no work has been done since that date on developing medium lift at the Pacific Spaceport Complex - Alaska, nor have there been any costs charged to this project since that time. The Medium-Lift Environmental Assessment is in the final stage of approval with the Federal Aviation Administration and we expect the final report within the next few weeks. There are no further costs associated with the EA. Currently, \$2,315,249 of the original \$3.0 Million remains in the AAC account.

In January 2015, AAC offered \$22.0 million of the medium-lift appropriation back to the state for re-appropriation to other state priorities. That was accomplished last year and that money no longer resides in any AAC account.

Concurrent with this, Governor Walker requested that AAC immediately reduce all state general funding requests for Operations and Sustainment to zero in the SY 2016 budget. We agreed, effectively terminating any future state funding to AAC with last year's budget.

You may recall that last year when I appeared before you, there were questions about the Administrations action to zero us out in the budget. You may also recall that I supported Governor Walker's action. I speak here today still in favor of that action. There are no state funds included in the SY 2017 state budget for AAC.

Finally, in response to questions you also may recall that I stated AAC would be exploring the possibility to privatize the company so that Alaska could retain a viable aerospace industry, without requirements for state funds.

So here we are today, no money requested in the budget and one year further down the road. But we have not been idle.

In January 2015 AAC presented the Administration a point paper recommending that privatization be considered as an alternative to shutting the corporation down.

In February 2015, the AAC Board of Directors authorized the company to proceed with evaluating alternative organizational structures and business models for AAC.

In March 2015, AAC hired Nossman, LLP to conduct the study. They evaluated nine different scenarios for potential transformation of the company away from state government.

During the May 2015 Board meeting Nossman presented these options to the Board and the Board directed that six scenarios be further developed for evaluation at the November meeting.

Governor Walker was briefed on the Board's direction in August 2015 by me and Dr Bob McCoy, AAC Board Chair. DMVA Deputy Commissioner Bob Doehl also attended the meeting. No action was requested of Governor Walker, AAC simply wanted to make sure the Administration was kept abreast of the Boards progress.

During the November 2015 meeting, the Board unanimously passed Resolution #15-06; a resolution recommending to the Governor that he pursue the transfer of the Alaska Aerospace Corporation to a Public-Private Partnership. So despite press releases by some elected officials that claimed *"The Alaska Aerospace Corporation needs to take the Alaska Legislature's message to privatize seriously and not draw out the process while using state money to stay afloat,"* the AAC Board of Directors has recommended that we be transitioned to a Public-Private Partnership.

Furthermore, AAC has not received any state funds since the FY 2015 budget, so our operations today are wholly paid by customer receipts and cash reserves. It is our intention to not use state funding in the future, but rather to privatize and be part of our states economic solution, bringing money into the state, employing Alaskans, and diversifying our economy away from being so heavily dependent on natural resource extraction and sales.

So now let me highlight the economic value of AAC to our state since becoming operational in 1996. I am sure you hear, like I do, the repeated pounding of the drum that “*Alaska Aerospace has NEVER made any money in its history.*” That is absolutely false. As I already mentioned, for the first fifteen years Alaska Aerospace launched sixteen rockets and never received a single state dollar for Operations and Sustainment. Facts are facts! During that period, AAC financially contributed to the state through the contracts we held with the Federal government.

But let me further present the fact that AAC has been a positive economic driver for Alaska. Since being established the **State of Alaska has invested \$58.7 million in AAC:**

- \$30.2 million in Operations and Sustainment funding, as previously explained;
- \$22.6 million Capital Funds for infrastructure development and deferred maintenance at the Pacific Spaceport Complex – Alaska (formerly the Kodiak Launch Complex); and
- \$5.9 million through the University of Alaska Science and Technology Fund.
- In total, AAC maintains a physical asset base valued at approximately \$57.0 million, following reconstruction of the damaged launch facilities, which will be approximately \$35.0 million.

In return, AAC has generated nearly \$300.0 million in “new money,” non-state revenues, accounting for 84% of total revenues for the company.

In further analysis, of the \$58.7 million in State funds, only 30.2 million was for Operations and Sustainment. The rest went directly into capital projects or education programs that facilitated our ability to attract new business. Therefore, the State received around nine dollars in “new money” for every State dollar invested for Operations and Sustainment.

Now, am I happy that the State had to provide \$30.2 million to AAC? Absolutely not! That is why I agreed with Governor Walker to eliminate state funding last year, to return the \$22.0 million CIP funding to the State, and to support establishment of a Public-Private Partnership company. By being a Public-Private Partnership there is virtually no risk that the State would have to provide further Operations and Sustainment funding, and it presents business model for the new company to potentially pay the State back the \$30.2 million over time. If AAC is shut-down, that \$30.2 million investment is lost forever.

But let me bring this closer to home. Our last launch in August 2014 generated significant economic benefit to the community of Kodiak. Over \$1.3 million in hotels/B&B, and lodge room rentals; approximately \$835,000 on food, beverage, and incidentals; \$250,000 on vehicle rentals; and another \$250,000 for logistics support was spent in the community during the launch campaign. This resulted in a direct positive economic impact to Kodiak of \$2.7 Million in “new money” to the community. This is in addition to the \$2.8 Million contract AAC had with Miltec to conduct the launch.

When all direct investments are accounted for, the 2014 launch injected over \$5.5 Million of “new money” into Alaska. Using a standard economic multiplier, the direct, indirect, and induced positive economic impact was at

least \$8.0 Million for that launch, with the majority being spent in Kodiak and Sand Point.

Returning to the macro evaluation of economic benefit derived to the State by AAC, when a standard economic multiplier is applied to the total AAC budget of \$356.7 Million, **AAC has provided over one half a Billion dollars in economic benefit to the state.** I think that is a positive message that is not understood by nearly enough people. But these are the facts.

Before I close I want to return to one more important point: For too long AAC has been synonymous with Kodiak. Our past behavior has validated that this assumption was correct; however, the past two years AAC has dramatically changed and this is no longer an accurate view of AAC. We are aggressively diversifying the company so that we are no longer solely dependent on launches from PSCA and have the ability to adjust resources as markets change. Let me provide some examples:

- We have a contract with Plant Labs as distributor of the Rapid Eye satellite constellation imaging data of Alaska. No matter who buys Alaska imaging data, AAC receives a commission.
- AAC is also pursuing installation and operation of data downlink earth stations in both northern Alaska and along the equator to allow us to down link data and do imaging processing as part of our vertical integration for imagine services.
- We have initiated work on Unmanned Aircraft Systems (UAS). We are part of the University of Alaska's Pan Pacific FAA UAS Test Range and have received FAA authority to apply for UAS Certificate of Authority (COA) for commercial UAS operations state-wide. We

are the only other agency in the state, besides the University, with this FAA approval. In fact, we have a partnership agreement with two commercial companies that are planning operations in Alaska later this year.

- We have a contract with Rocket Lab USA to provide Range Support and Launch Director services for their first four Electron rocket launches from their New Zealand facility, scheduled for 2016 and 2017. This will ultimately lead to launches from Alaska projected for late 2017 or early 2018.
- AAC received \$2.6 million in Federal funds in the FY 2015 budget for capital improvements at PSCA to support future Federal operations from Alaska. AAC also has a request in for \$5.0 million of Federal funds within the FY 2017 budget.
- The AAC Board of Directors passed a resolution in February 2016 authorizing AAC to proceed with development of a Joint Venture for marketing our Range Safety and Telemetry System (RSTS) worldwide.
- The AAC board also passed a resolution in February authorizing AAC to proceed with establishing a wholly owned subsidiary to provide launch services world-wide. These launch services are the services currently provided at PSCA, but our intent is to expand the business unit to obtain work at other launch facilities, thereby generating revenues when the team is not needed in Alaska.
- AAC is actively pursuing development of an equatorial launch site to compliment the current polar capabilities of PSCA. It is the intent of the Board that AAC have the ability to serve customers equatorial

and polar requirements. This would significantly increase potential revenues, as the majority of launches require equatorial orbits.

- And finally AAC is in the final negotiations with a customer that will use PSCA, with the first launch in 2017. This will be a multi-year, multi-launch program that has the potential of being a prime customer for the next five to ten years. While I can't provide any further information than this due to the sensitive nature of contract negotiations, I can say that we expect a public announcement will be forthcoming from the customer in April.

What else can I say? I guess I will close by telling you that:

- Four years ago AAC had over forty state employees. Today we have only sixteen.
- Over the past four years I have not provided any Cost of Living Allowance (COLA) increase to any of our state employee workforce. While the state budget included COLA, we did not implement it at AAC and never received the money from the State.
- We also have not provided raises to our state employees in the past four years. I recognize that AAC employees are well paid and that the state is facing serious financial challenges.
- Alaska Aerospace Corporation is transforming into a diversified company that, in this past year, has demonstrated the resilience of our workforce to create new opportunities and secure new business for Alaska.

Conclusion:

AAC wants to be part of the solution. That is why our Board has recommended to Governor Walker to proceed with the Public-Private Partnership, create the environment to allow AAC the potential to repay the \$30.2 million back to the state, and diversify our economy at a time when we can ill afford to see more Alaskans unemployed or be sending a message to the world that Alaska is NO LONGER an aerospace state.

Thank you for your attention. I would be glad to answer any questions.

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