Good day. And welcome everyone to the Lockheed Martin Fourth Quarter and Full Year 2014 Earnings Results Conference Call. Today's call is being recorded.

At this time, for opening remarks and introductions, I would like to turn the call over to Mr. Jerry Kircher, Vice President of Investor Relations. Please go ahead, sir.

Jerry Kircher

Thank you, Shannon, and good morning, everyone. I'd like to welcome you to our fourth quarter 2014 earnings conference call. Joining me today on the call are Marillyn Hewson, our Chairman, President and Chief Executive Officer; and Bruce Tanner, our Executive Vice President and Chief Financial Officer.

Statements made in today's call that are not historical fact are considered forward-looking statements and are made pursuant to the Safe Harbor provisions of Federal Securities Law. Actual results may differ. Please see today's press release and our SEC filings for a description of some of the factors that may cause actual results to vary materially from anticipated results.

We have posted charts on our website today that we plan to address during the call to supplement our comments. Please access our website at www.lockheedmartin.com and click on the Investor Relations link to view and follow the charts.

With that, I'd like to turn the call over to Marillyn.

Marillyn Hewson

Thanks, Jerry. Good morning, everyone and thank you for joining us on the call today. We hope that your new year is off to a great start.

Let me begin by saying that I am extraordinarily proud of our Lockheed Martin team. We finished another strong year in 2014 achieving excellent financial and program performance. Our performance has the corporation well positioned to continue to deliver value to customers and stockholders in 2015.

The daily efforts of our employees are the foundation of our ability to deliver broad-based results across the corporation and I thank them for their ongoing contribution. While Bruce will cover the financial results in detail later on in the call, I want to highlight a few key achievements and strategic items from my perspective as we closed out 2014.

Starting with new business, the corporation continues to be successful in securing new order bookings for both domestic and international customers. In the fourth quarter we achieved a strong 130% book-to-bill ratio for contract awards above sales and finished the year with a backlog of nearly $81 billion.

This marks the fourth consecutive year that we have maintained our backlog in excess of $80 billion.

Our new business success is aided by having the best position portfolio of programs in the sector with direct and unique alignment to many of the essential programs identified by both international and domestic customers.

These factors have enabled us to build a strong backlog consisting of multiple years of longer cycle production program and provides a strategic differentiation and financial foundation of future work.

I was also pleased that the international content of our backlog grew to more than $20 billion, representing over 25% of our total yearend backlog. The international component has us well positioned to achieve our stated goal of expanding sales from international customers to at least 25% of total corporate sales in the next few years.

This expected international growth also provides a significant benefit to our domestic customer by enabling economies of scale and additional cost leverage achieved through higher production volumes on programs across our portfolio.

Strategically, our corporate-wide emphasis on fast [training] [ph] and expanding customer relationships and focusing on how we may best support their critical needs continues to provide a pivotal role in securing new business awards.

This past quarter, I had the opportunity to expand our international relationships by travelling to the Middle East and meeting with key customers. My activities in Abu Dhabi included participating in the opening of our Center for Innovation and security solutions in Masdar City, further strengthening the corporation's nearly 40-year relationship with the United Arab Emirates.

I also travelled to Bahrain for discussions with high level representatives on our products and how we can best help them satisfy their critical national security requirements.

The common theme across my meetings was that all parties I spoke with reaffirmed their unwavering desire to secure the most effective solutions and products essential for national security, in spite of any volatility in world oil markets and price levels.

Another strategic focus area where we have a long record of success is the generation and deployment of annual cash flows. In 2014, we generated almost $3.9 billion in annual operating cash after making $2 billion in pension contributions. This strong cash generation enabled us to provide a return of over 120% of our annual free cash flow to stockholders in 2014.

As we enter 2015, we are solidly on the cash deployment plan we outlined during the October call, where we identified our goal to make at least $2 billion in share repurchases in 2015 and to reduce our total outstanding share count to below 300 million shares by the end of 2017.

Share repurchases of this magnitude, coupled with our annual dividend payments would result in returning virtually all of our annual free cash to stockholders over the next three years.

Beyond the significant returns of cash to stockholders, our increasing cash flow also enabled us to invest in the future of the corporation in areas such as research and development. We continue to expand our focus and allocation of resources on next generation technologies and products.

In 2014, we increased investments in independent research and development activities to over $750 million, reflecting the third consecutive year of significant increases in the strategically important area.

We are constantly pursuing new technology based solutions as we design and develop leap-ahead technologies to help address some of the world's most complex challenges faced by domestic and international customers. These efforts will ensure we stay at the leading edge of technology and create potential foundations for future new business and important strategic positioning.

Moving to operations, one of the highlights of this past quarter was the near flawless inaugural test flight of our Orion spacecraft. This flight successfully tested key systems of the capsule to help pave the way for future missions into deep space and capture the imagination of people around the world.

The flight successfully tested a number of technologies that are fundamental to future deep space missions and included environmental and safety elements essential to the future of human space travel.

We are extraordinarily proud and pleased to be the prime contractor of the Orion vehicle and look forward to proving this unique exploration vehicle -- I am sorry, look forward to providing this unique exploration vehicle to NASA and our country for decades to come.

In addition to the Orion operational achievement this past quarter, key milestones were also achieved on the F-35 Joint Strike Fighter Program with progress in developmental testing and increased production quantity and tempo.

On the development program, a major milestone was accomplished with the F-35 carrier variant, successfully completing on-ship trials aboard the USS Nimitz.

The maturity and performance of the aircraft enabled achievement of 100% of the threshold test points and also included multiple successful night landings and launches during the aircraft's first test deployment at sea.

Beyond the carrier test for the U.S. Navy, we are also on track to provide the capabilities of this revolutionary fighter to our armed forces, with initial operational capability of the F-35 STOVL variant for the U.S. marine core later this year.

In the projection arena, I am very proud of our aeronautics team as they achieve the delivery target of 36 aircraft in 2014. This was particularly noteworthy as the team was able to overcome a nearly one month program hold for the engine anomaly that occurred last June and still achieved annual aircraft delivery goals.

This achievement is further illustration of the program’s growing stability and production ramp up. Overall, the F-35 aircraft fleet continues to expand with 109 production jets delivered since program inception and fleet operations now surpassing 25,000 flight hours.

Customer support and funding for the program is strong and growing. Finalization of the LRIP-8 contract was completed this past quarter for 43 aircraft, reflecting a significant increase in order quantity above the 32 to 36 annual aircraft awards we received during the previous four fiscal years. This new award helped bring year-in 2014 backlog of aircraft on the program to 100 planes.

Looking forward, domestic and international customers, order phasing, outline of plant procurement of 61 aircrafts for the upcoming LRIP-9 contract, further expanding the solid growth curve in aircraft quantity.

This increased rate of aircraft orders is an essential component to our ability to ramp up production levels and achieve the reduced price of the planes outlined in our blueprint for Affordability Agreement with the F-35 customer.

I would like to conclude my remarks with a brief status of government budget. Last month, the U.S. Government passed the fiscal year 2015 omnibus spending bill to finance most federal activities through the end of the current fiscal year. Passengers have still eliminated much of the procurement uncertainty caused by operating under the prior continuing resolution constraints.

Looking forward, the White House is scheduled to provide Congress a proposed fiscal year 2016 defense budget next week on February 2. The proposed DoD base budget is widely expected to be higher than the FY'15 level and above the mandated sequestration caps.

The higher budget request is in response to increase global security threats and military needs. The FY'16 proposed budget will then undergo congressional deliberation and final spending priorities and funding levels over the coming months.

While the impact of the likely higher FY'16 proposed budget on future fiscal years is unclear at this time, a higher FY'16 spending authority could signal bipartisan recognition of the critical need to increase DoD budget levels above the currently constrained limits established by sequestration.

These recent budget actions are positive steps in the creation of a more predictable and strategic approach to budget allocations, while addressing the fiscal challenges we face as a nation.

I'll now as Bruce to go through the details of fourth quarter and full year 2014 financial performance, our financial outlook for 2015 and then we'll open up the line for your questions. Bruce?

Bruce Tanner

Thanks Marillyn and good morning, everyone. I hope you're all warm and drier this stormy day. As I highlight our key financial accomplishments, please follow along with the web charts that we provided with our earnings release today.

Starting with chart three, and an overview of our year-end results, we had a stronger finish to 2014 than we were expecting when we last spoke in October. Sales for the year were $45.6 billion and I'll discuss that in more detail on the next chart.

Segment operating margin was 12.3% for the year, about in line with our expectations and the combination of higher sales and segment operating profit drove our earnings per share to $11.21, higher than the guidance we provided in October, but there were two unplanned items that had a net negative impact on the fourth quarter that I'll discuss in a few charts.

Cash from operations was nearly $3.9 billion after making $2 billion in pension contributions, including $1 billion in the fourth quarter as we discussed at that time.

And finally orders for the fourth quarter were a little higher than expected, resulting in our inning backlog of $80.5 billion. So overall we had a good finish to a strong performance year.

On Chart 4, we will discuss our sales results in more detail. In the fourth quarter, sales grew by almost 9% compared to the same period in 2013 with four of the five business areas showing strong growth in the quarter.

Aeronautics growth was driven by volume increases on the F-35 production programs. Missiles and Fire Control had higher deliveries of PAC-3 missiles as well as higher tactical missile deliveries, mission systems and training had higher radar volume including the start-up of the Space Fence program and Space Systems grew primarily due to the Orion flight test that occurred in the fourth quarter. Our fourth quarter performance led to full year of 2014 sales achieving slight growth over the 2013 results.

On Chart 5 we will review our earnings per share for the quarter and year. Fourth quarter EPS was $1.32 higher than the prior year, driven primarily by three items.

The change in the FAS/CAS adjustment from an expense in 2013 to income in 2014, the absence of the restructuring charges taken in 2013 and a lower goodwill impairment charge in 2014 that occurred in 2013. I'll describe the goodwill impairment charge taken in the fourth quarter in more detail on the next chart.

For the year, EPS was more than $2 higher than in 2013, driven again primarily by the FAS/CAS adjustment change in the essence of the restructuring charge in 2014.

Turning to Chart 6 to reconcile our actual earnings per share results with the guidance we provided in October. In October we projected our EPS for the year to be around $11.15 per share.

And as I mentioned previously, we had two unplanned events that were not considered in the EPS outlook we provided last quarter, the first of which was a special charge we took for goodwill impairment in our tech services line of business.

And this was in Fire Control, this chart reduced our EPS by $0.33 and this was the second consecutive year we've had an impairment charge against this business and again reflects both a reduction in support activities in theater, as well as the increased level of competition we're seeing for this business.

The second unplanned event was the passage of the R&D tax credit legislation in the quarter, which generated a $0.14 benefit to EPS. These two events lowered our outlook for EPS by $0.19, but were more than offset by the higher sales and segment operating profit in the quarter.

Chart 7 provides more detail into our cash deployment actions in 2014 with cash from operations of nearly $3.9 billion and capital expenditure of around $850 million, our free cash flow for the year was a little more than $3 billion and after making dividend payments of nearly $1.8 billion and share repurchases of $1.9 billion, we returned 121% of free cash flow in the year.

Over the last 10 years, we've made $30 billion of dividend payments and share repurchases to our shareholders or 108% of free cash flow over that same period.

On Chart 8 we show our backlog results of the last four years. Our backlog levels have remained above $80 billion and each of the last four years despite the budgetary pressures that our customers are facing. As has been the case in prior years a strong fourth quarter in 2014 enabled us to achieve these results.

Chart 9 provides significant assumptions in our 2015 guidance. Our FAS [audio gap] resulting in the lower discount rate at year end.

Asset returns in 2014 of 6% rather than 8% assumed in October make up the remainder of the lower income outlook. While affecting GAAP EPS, these pension changes do not create the need for any additional cash contribution over the next three years.

As I noted in the October call, we do not expect to make pension contributions from 2015 through 2017 and our expectations of generating more than $15 million in cash from operations over the next three years remains unchanged.

Consistent with our longstanding practice, our guidance does not assume an extension of the R&D tax credit until legislation is enacted. If legislation similar to what was enacted in 2014 is passed in 2015, we would expect the EPS benefit to be comparable to the 2014 amount. And consistent with what we discussed last quarter, we plan to make at least $2 billion in share repurchases in 2015.

Turning to chart 10, we provide our current outlook for 2015. Our guidance today is consistent with what we provided in our trend information in October except for the lower FAS/CAS adjustment.

We expect both orders and sales to be in a range from $43.5 billion to $45 billion, and we expect our backlog to remain above $80 billion at year-end for the fifth consecutive year.

We expect our segment operating profit to be between $5.1 billion and $5.25 billion. Our EPS is expected to be between $10.80 per share and $11.10 per share. And our cash from operations is expected to be greater than $5 billion.

Chart 11 shows the ranges for sales and profit by our business areas. And finally, chart 12 is our summary. 2014 was a strong year, both operationally and financially. We are confident that our portfolio has us well-positioned for the future and we remained focused on the cash deployment actions that our shareholders expect.

With that we're ready for your questions. Shannon?

Question-and-Answer Session

Operator

Thank you. [Operator Instructions] [Audio Gap]

Unidentified Analyst

…And then, it also appears net of disposals that you spent the most on acquisitions this year that you have since 2006. I wonder if you can just provide a little bit more detail on the strategy with regard to R&D, where the spending might be going and how the customer is behaving these days with regard to independent R&D versus them paying for your R&D. And whether we ought to view the acquisitions that you've been making here at late as kind of an extension of R&D. You're acquiring technologies that perhaps you didn't have and where you find the growth areas and just kind of the strategy behind R&D in the acquisitions going forward holistically.

Marillyn Hewson

Sure. Thanks for the question, Jason. I get just first to talk a little bit about R&D and new technology. We have been increasing our R&D expenditures over the past three years.

This year we were up -- for 2014 we were up another 8%. And we're doing that because we're not going to cut back on R&D even though that our sales are not growing at the same trajectory that they have maybe for the past decade or so. Because it's really the lifeblood of our company and we are a technology company and we have to continue to invest.

From our customers' perspective, we do spend time with our customer on our R&D plans. And lot of credit to Secretary Kendall in bringing us into the Pentagon to talk about our top IRAD expenditures and areas to make sure that we're well aligned with what the priorities are for the Department of Defense.

And moreover, as we look at our customers around the world, we're looking at how do we invest in research and development that will allow us to secure new business and to grow our current business.

Beyond that we're a long cycle business, so we're constantly looking at how we can continue to invest for the long-term as well. So it's a balance of both of those areas to make sure that we're looking at things that would be giving our allies and our customers an advantage over their adversaries for the long-term.

In terms of how we address R&D and cooperative research and development, we kind of look at both of those elements as being an important part of investment, but we also are doing things that are beyond IRAD investment.

For example, we use other avenues to develop next generation products and solutions. If you look at what we're doing on the U.S. Air Force's T-X competition that's coming out in 2017, we actually had teamed with South Korea to develop the T-50 supersonic trainer for their air force under an offset program and we're able to take that investment that we made in an offset program and point it toward the T-X competition.

So that's a great example of where you might not necessarily see it in the value of an R&D investment that we're making those investments. I think if you look back, years back we did a similar thing on the C-130J which is just paying dividends for us in the markets that we're operating in with the C-130J program where we made investments in our business along that line.

Taking it on beyond that into acquisitions, yeah, we did more historically than we have done this year in 2014. There are areas that we're continuing to penetrate into our core, such as our Zeta Associates acquisition and that being very much aligned with our core.

Some areas such as the healthcare IT arena and Systems Made Simple is an area that is part of our IT work with the U.S. government where we've been frankly for the past 20 years, the top supplier of IT support, and this is an opportunity for us to bring more to markets like the VA medical, DoD medical, etcetera.

The Astrotech acquisition we made in space launch is very much aligned with our core with services there. But then we're also looking at areas to bring in additional capability to the corporation in places where we want to take our core into new markets like [indiscernible] with the IT work we're doing in airports and things along that line.

What I will say is that as we've said, we have a very strong cash deployment plan that we're going to follow, but we also are generating cash and we also have a lot of financing capability as a company.

That debt capacity allows us to have the flexibility as we see additional opportunities for acquisition that make sense for us that allow us to continue to invest in M&A. So we'll be looking at acquisition that are, as you said, able to add capability, but also ones that open up new markets for us that are closely aligned to our core capabilities.

Operator

Thank you. Our next question comes from Ron Epstein of Bank of America. You may begin.

Ron Epstein

Yeah. Good morning. Sorry if my connection is a little weak, just working remotely here. Maybe just a follow-up on Jason's question. By my calculations you guys will -- you spent something like 1.5% of sales on R&D, is that enough?

When you look at other technology companies, they'll spend multiples of that. I mean how do you think about that, Marillyn?

Marillyn Hewson

Well, I don't think you can look at the absolute dollars, honestly, because I think when you look at our portfolio and when you look at what we've done over the years, it's not a matter of percent of sales so much as it is the efficient expenditure of R&D dollars.

So we've made choices in things such as JLTV, the Joint Light Tactical Vehicle, which is a large opportunity that we're pursuing, that hopefully the award later this year will bring to us an opportunity that is a significant new growth market for us. And that started with an acquisition some years ago that brought some technology in and then we built on that technology. So it's not just the dollar level on a percent of sales.

And the other thing is, if you look at things that if you look backward -- I mean I don't think we missed anything in terms of our portfolio and things that we have won because we have and invested in research and development for the long-term.

Operator

Thank you. Our next question is from Pete Skibitski of Drexel Hamilton. You may begin.

Pete Skibitski

Good morning, guys.

Marillyn Hewson

Good morning, Pete.

Pete Skibitski

Maybe one for Bruce. Bruce, I was wondering if you could help us again, maybe update us like you did in the last quarter on the cash from ops and bridge from '14 to '15.

Just because it looks like maybe cash taxes were a little higher than expected in '14. You've got obviously zero pension cash needs in '15. It seems like maybe $5 billion is good as it is, might even be conservative. Can you help us understand why that could be what you do?

Bruce Tanner

Yeah. So, Pete, let me try that. I tried to give some of this in the October call, but I think it's probably worth repeating just to make sure everyone is on the same page.

So, I think the simple math would say you did $3.9 billion in 2014; you did $2 billion of pension contribution. It seems like you should be around $5.9 billion versus the $5 billion. I think there’s kind of two or three pieces, probably two that drive most of that.

One is we have additional -- because of the $1 billion contribution made at the end of the year '14, we're going to get actually tax deductions worth about $350 million in '14 that won't carry over into 2015.

We also had in '14 a tax refund of about $0.25 billion, so $250-ish million or so I think was the number. So that's what $600 million or so, a sort of bridge from just a cash taxes, if you will, either refunds or cash out for taxes.

And then the last thing, if you just look at our -- at the level of income that we're projecting from 2014 and 2015, we're down a couple hundred million dollars, so if you just translate those earnings into cash that pretty much makes up the difference about $900 million.

And again, I'll remind you, Pete, we keep saying we're expecting to be a little greater than $5 billion and I think that potential is still there.

Operator

Thank you. Our next question is from Rich Safran of Buckingham Research. You may begin.

Bruce Tanner

Rich, you there?

Operator

Rich, your line is open. Please check your mute button.

Jerry Kircher

Shannon, let's move to the next one.

Operator

Our next question is from Carter Copeland of Barclays. You may begin.

Carter Copeland

Hi. Good morning, all.

Marillyn Hewson

Good morning.

Carter Copeland

Marillyn, I really appreciate the comments on international post your visit, but I wondered if you might give us a little bit more color about how you think about how much of your business is those sort of core strategic capabilities that you're delivering to those customers versus the stuff that is perhaps more support oriented or perhaps commoditized in some way.

Is there a way to kind of rack and stack your international business and say this portion applies to the key capabilities like THAAD and PAC-3 and the like? And how should we think about that?

Marillyn Hewson

So, I'd say first off that the key areas of growth for us internationally are certainly in the missile defense area in Asia-Pacific and the Middle East. Just as you mentioned, it's THAAD, its Aegis, Aegis Ashore, Patriot, potentially MEADS we hope to sell in addition to that F-35. I mean those are core and that's the majority of our growth in the international. It's our core business that we're growing.

Now we are having some additional areas of growth and things like cyber, which is an expansion of work that we've been doing for years for the U.S. government that we're able to grow into other areas; our IT work.

But the big dollar items within our growth in international are core business that we have, C-130Js, continue to sell F-16, the air and missile defense, the U.K. turret for the scout vehicle and for warrior, things of that nature. Hopefully that answers your question, Carter.

Operator

Thank you. Our next question is from Noah Poponak of Goldman Sachs. You may begin.

Noah Poponak

Hi. Good morning, everyone.

Marillyn Hewson

Good morning.

Bruce Tanner

Good morning, Noah.

Noah Poponak

I wanted to ask about two bigger programs, new programs on mature computing and just kind of get a broad update from you. Maybe on LRSP, I was specifically wondering if you could talk about work with theoretic will be done and if capacity were need to be added.

And then, if there's anywhere as well update on JLTV and on that one if you could potentially size what that could ultimately be for the company if there as a win. Thanks.

Marillyn Hewson

Well, first of all, LRSP I can tell you that we're teamed with Boeing. We think we have a very strong position on that program and pursing it, and there'll be a word sometime this year and that's all about I can tell you about them. I'm sorry, but that's that all I can say.

In regard to JLTV, it’s a very significant opportunity for us. The RFP is out; our proposals are due early in February. And the award for that is projected again this year, we think mid-year, we don't know.

Our guess is as good as yours as which quarter because as we know a lot of times protest immerge and things of that nature. But in terms of the program itself, it’s a big opportunity for us. Bruce, in terms of size I think you go ahead.

Bruce Tanner

Yeah. I think, Noah, the -- I think the RFP came out and there's they're asking for various production quantities over various years, sort of the stated number of vehicles is somewhere around 17,000 vehicles and you can probably do the math as well as anyone as far as what that total production program would be for.

But it’s -- we should think about it as a multi-billion dollar sort of award for the initial proposal which is the development program in the first few LRIP contracts. And then it's got potential obviously well beyond that for both additional domestic vehicles as well as the international market place.

So this is although the initial award that we're expecting to have happened this year hopefully without protest pushing it out is not all that sizable. The strategic opportunity is very great.

Marillyn Hewson

I could add on that one where we're going to produce it going to you talk about that. So it's in Camden Arkansas we have facility there where just this past year we went through the production readiness review with the U.S.

Government and it was very successful and so we're excited about the opportunity on the JLTV.

Operator

Thank you. Our next question comes from Doug Harned of Sanford Bernstein. You may begin.

Doug Harned.

Good morning.

Marillyn Hewson

Hi Doug. Good morning.

Doug Harned.

I am interested in your thoughts around how you work with the changing budget, by that I mean if you look forward, we're at a point where their prospects for arising budget, arising base budget certainly, but at the same time, we're seeing the end of a lot of operational activity in theater that's been going on for many years.

So when you look at this how do you think about your exposure to some of the con ops that have been going on? Is there much left and where is it and then at the same time, how do you think about investing where there is going to be growth and not just R&D, but BMT, potentially facilities. How do you manage this transition?

Marillyn Hewson

Thanks for the question Doug. I would say that we spent a lot of time on our strategic planning as a company and keep a beat on what's happening in the environment that we're operating in and we look both and where the opportunity are relative to growth in the DoD budget as well as you know our focus on the international market place.

And we look at you know the -- sure there is a draw down in regions where we're bringing our war fighters home and that has some impact on things like our services business and things of that nature.

But where the real opportunities for ours are is to not only continue to grow with the F-35 program, which today represents 17% of our sales and will continue to grow to a larger percentage in 2015 and beyond.

As we just talked about, the Joint Light Tactical Vehicle, JLTV is the big opportunity for us. We're looking forward to C-130J multiyear opportunity really to our combat ship and as the U.S. Navy moves forward with their 52 ship buy on the small surface combatant, so going beyond the current Littoral combat ship, those are all areas for growth.

And as we -- we believe that we do have the strongest portfolio. So we're constantly looking at as the U.S. Government determines where they have to recapitalize, then can't sit still either even though in this current timeframe may be the situation in terms of a war environment is not as high.

Will they use up a lot of aircraft and a lot of systems and vehicles in those wars and they've got to recapitalize and when we believe we're well positioned to take advantage of that because we are continuing to focus on providing greater capability and new technology and take an advantage of that advanced technology.

So that’s where our R&D, our bid proposal etcetera, on facilities we have looked at how we take capacity out. We've taken out over seven million square feet of capacity since 2009, but at the same time, we've opened some new labs, we've opened up some new areas.

So I think what we try to do is adjust our capacity to not only the business space, but to the areas where we need to invest to continue to grow as a business.

So I think we do a good job of assessing the changes in the environment that we're operating in and we adjust our facilities, our investments and our pursuit of acquisitions and research and development funding accordingly.

Operator

Thank you. Our next question is from Sam Pearlstein of Wells Fargo. You may begin.

Sam Pearlstein

Good morning. I wanted to actually somewhat follow-up on that last question, which is the guidance has top-lined down in 2015 a few percent at the midpoint. You did make some 900 million worth of acquisition.

So I guess first part, which is what is the organic sales trend in 2015, and also given budget trends, can you see positive year-over-year sales in 2016 at this point and if not, what does it take to get there.

Bruce Tanner

Hi Sam. I'll take that one on. So you're right, we talked about roughly $900 million in acquisitions in the year. I think the inorganic growth in the year 2014 was about a little less than $250 million. And you should think of that growing to about three quarters of a billion dollar or so, about a $0.5 billion increase in inorganic growth year-over-year from '14 to '15.

So that's sort of where we see that playing out there. I think it's important to note that in our planning of 2015 and what we've talked about up to this point is all based on the current Budget Control Act without consideration of what Marillyn was talking about in her opening remarks about the potential increase in the FY '16 budget.

As we look at that, the interesting thing, and I know, I've talked to you guys about this in some of the investor conferences, I think the interesting thing is not necessarily what happens with the FY '16, it's what happens with the budget beyond FY '16 because if you just get the spike in FY '16 and then you go back down to the Budget Control Act, you really go back down to levels that cause an elaboration in '16 and then you're back square one in FY '17 and beyond and it doesn't make a whole lot of sense from a strategic planning perspective.

I'll say even with that scenario, again we don't have either spike in FY '16 in our planning outlook, nor do we have anything in FY '17 and beyond. We do believe, we will start to see growth in FY '16 and particularly within the aeronautics business areas where we're expecting to see growth and I'll say, as I sit here today Sam, I feel pretty comfortable actually saying we're going to see some growth -- organic growth starting in FY '16 or 2016 above the 2015 level.

And at least our planning, Sam, for years beyond '16 assumes that that growth continues. So we're sitting actually looking forward to that with the potential for hopefully some good news coming out of the budget -- the President's budget process in the not too distant future.

Operator

Thank you. Our next question is from Rob Stallard of Royal Bank of Canada. You may begin.

Unidentified Analyst

Thank you. Good morning. Its [indiscernible] for Rob Stallard.

Marillyn Hewson

Good morning.

Unidentified Analyst

Marillyn, I was wondering if I could follow up on Carter’s question and your comments about visiting the region last year. You made a lot of investments there, which very much you mentioned at Masdar as well as [indiscernible].

Is your sense in talking to your customers there that the current energy prices going to have any impact on the pace at which export contracts could be awarded in the medium term.

Marillyn Hewson

Well we're really not seeing any pull back on their expenditures on national security, because that in terms of their priority, that's very important and it's true that for a lot of our key countries, that's an important source of revenue for them.

But when you look at countries like the Kingdom of Saudi Arabia, UAE, Qatar and others, they have very substantial government reserves and so what they're looking at -- as long as the prices don’t stay down for a long extended time, which none of us know how that will play out, but we've not seen anything that would impact our portfolio and what we bring.

So no change so far on their critical means, they still have -- they will operate in dangerous neighborhoods and they still have needs for missile defense and tactical aircraft and range of communications systems.

Perhaps there may be some pressure on some of our less priority programs such as IT upgrades, or services, or things of that nature, but in terms of the big ticket items and the items that I am having the dialogue with them about it has not come up. I think they're very much focused on their highest priority requirements and those happened to be the things that we can bring to them as we move forward.

Operator

Thank you our next question from David Strauss of UBS. You may begin.

David Strauss

Good morning.

Bruce Tanner

Good morning.

David Strauss

What specifically with F-35 program, it looks like last year you had about an $800 million increase in sales, but no increase in prop as it relates to the production program.

Can you talk about what you got baked into your number this year some up any sort of EBITDA increase out of production program. And then second question Bruce can you talk about the advanced line, I think it was like about $500 million drag, can you just talk about the outlook for advance systems here? Thanks.

Bruce Tanner

So David, I think your map is pretty accurately. We were a little bit flat. I am just looking at some numbers here in terms of the production program. We actually had a overall profit actually -- let me just take a peak here.

Overall profit actually was up slightly on the F-35 program in total, the production program and that's primarily because of the lack of the SPD write-off that we took in 2013. But the production program was fairly flat in terms of total profit dollars and actually the margin was down. I think that's the point that you're have talking at.

We had some step ups on the production early contracts in 2013. We had some planned step-ups in 2014, some of which we took, but not all of which that we had planned did we take in 2014. So that got pushed off to the right and that caused the situation that you're describing in 2014.

As we look forward to 2015, I am still expecting and I know we've talked about this as recently as the Investor Conference we had in Fort Worth. I am still expecting a 100 basis points or more improvement in the F-35 production program margins between 2014 and 2015.

And we're hopeful that that trend will continue at least year-over-year sequential increase in the margins on the production program in years thereafter, but the biggest spike we're expecting is between 2014 and 2015.

And I think a big reason for that maybe -- we closed the year pretty strong from a production perspective on the F-35 program. We had a month -- almost a two-month delay in production activities or at least delivery of the aircraft because of the engine anomaly that occurred in 2014. Yet we made all 36 aircraft delivers. We actually had a chance to exceed that number.

So I think as we closed out the year, things were looking and feeling better on the production program than say when we started the year and I am hopeful that that trend will continue into 2015 and that's what we're banking on with that margin increase.

On the customer advances, that I think the actually burn is about -- we're expecting it to go down about another couple $100 million or so. You're right, it was down about a $0.5 billion from '13 to '14.

Some of that is simply the nature of -- we're actually seeing a little bit of conversion from and I think we've talked about this from some of our direct commercial sales contracts to more and more FMS contracts that tend to get negotiated concurrently with the U.S. Government buys.

We're seeking that for instance on the F-35 program with aircraft and we're seeing that also on a lot of missile program be they Hellfire missile, [indiscernible] PAC-3 and the like.

So a lot of the -- a lot of the historical and this is just in large part due to the customer change, but a large part because of the F-35 growth, which is all going to be FMS in the near term.

We're seeing some burn down of sort of the legacy, direct commercial sales. It has not been replaced by new commercial sales down payments in part because those are in fact FMS contract. Kind of long-winded answer to that question, David. Hope that makes sense for you.

Operator

Thank you. Our next question is from Joe DeNardi of Stifel. You may begin.

Joe DeNardi

Yes thanks. I guess just another one on the F-35 if you could just kind of talk about what caused some of those step up to get pushed out of 2014 and how the budget outlook for that program, which seems to be improving kind of plays into how do you think about the margin profile improving on the production side?

Bruce Tanner

Yes, so Joe, I'll take that one as well. So we always go through at every year thinking that there is a planned level of booking rates and especially on programs that are early in their life cycle as is the F-35.

And in 2014, we had planned to have some increases on the production program and again for the reasons that I described to David, some of that were simply in the early part of the year it made no sense whatsoever to have margin increases when we're actually sitting ideal because of the engine anomaly.

And that did cause some disruption overall to the performance at about first half of the year leaking into the second half of the year and so that caused some of those increases to get pushed out just as I described. That's the reason I was making the point.

I think where we ended the year was a good point for us on the production programs. And that does give us the confidence that 2015 you will see those step ups made. And that's the reason for the margin improvement that I talked about with David.

And again, our expectation is a little bit spiky from '14 to '15 in terms of a pretty good sized jump in the margins on the production program, but thereafter we continue to expect that margin to increase year-over-year as we go through the production program.

Operator

Thank you. Our next question is from Joe Nadol of JPMorgan. You may begin.

Joe Nadol

Thanks. Good morning.

Bruce Tanner

Hi, Joe.

Joe Nadol

Hi. So, on Aeronautics F-35, I was wondering, Bruce, if you might give little bit of an update. Obviously, we had our meeting a couple months ago in Fort Worth, but just little update on where you stand on deliveries this year for -- specifically for F-16 and C-130. And then, key pursuits, little bit about the multi-year in particular on the C-130 side. Thanks.

Bruce Tanner

Yeah. Thanks, Joe. So let me give you just sort of a -- may be a long-winded answer to the question. So F-16 deliveries -- I think to keep this up in the past, we're going to drop -- I think I keep this up in the October call. We had about 17 -- not about, we had 17 aircraft deliveries for the F-16 program in 2014.

We're building about one a month, you should think of it. So we're looking at about 11 or 12 deliveries probably in 2015. I think current contract schedule would consist of 11 aircraft there.

On the C-130, we're at a pretty steady build rate between years. We did 24 aircrafts in 2014. We would expect to do 24 aircrafts in 2015 as well. And that's -- again that's the expectation.

That's sort of a good build rate. In fact; we'd prefer to sort of build with that steady rate as oppose to having sort of spikes that would cause us to have a little bit of disruption. We'd rather build at that steady rate. And with the backlog that we have in the program, we're able to do that.

C-130 multi-year, so we got I'd say some partial funding on that at the end of 2014, and we expect to close the rest of that, the balance of that in 2015, but the value is not as large as it was at the end of the year, the sort of partial funding, on a fiscal year basis towards that multi-year.

Joe, maybe inherent in the question -- I'm sorry, I didn't talk about the F-35 program. So we did 36 aircraft deliveries in 2014. That number is going to increase probably in the 40, maybe a couple more than that.

We're actually working with the joint program office later in the month of February to sort of finalize the production delivery plans. And we do that because it actually does require resources on both sides, both the government resources as well as company resources to do this.

So we'll have a better idea and more definitive idea of the F-35 deliveries next -- probably next time we talk to you in April. But I would expect that we'll be somewhere in again the 40, may be a couple more than that as we said here today.

And then the last aircraft program I guess for the Aeronautics business area, we delivered seven C5s in 2014, we expect that number to go up to nine deliveries. And I think we stayed at about that level probably until the program winds down through the last delivery of the C5 modernization program.

One thing while we're talking aircrafts and deliveries and quantities, Joe, I want to make sure that everyone understands as at least we look at sort of the phasing of our revenue in 2015 it's going to be bit on an odd year. We're very, very heavily weighted in the second half.

The first quarter, in particular, is very unusually low, or we expect it to be very unusually low on a compare basis because of our delivery phasing. And that's both associated with the Aeronautics aircraft that I just talked about.

I think we've got two fewer F-16s in the first quarter and two fewer C-130s both in the first quarter of 2015 compared to the first quarter of 2014. But combined that with the fact that Missiles and Fire Control is going to have a pretty significant drop off in the first quarter of deliveries of their missile programs, both tactile missiles, PAC-3s and the like.

We could see the first quarter revenue being down as much as say 5% year-over-year compared to the first quarter of 2014. And then, obviously, it will build from that point on to the levels that we're seeing for the full year for 2015, so a little bit of an unusual pattern for us.

We always have the pattern where the fourth quarter is higher than the rest, but we're starting off 2015, our least expectation probably a little lower than it ordinarily would.

Operator

Thank you. Our next question is from Myles Walton of Deutsche Bank. You may begin.

Myles Walton

Thanks. Good morning.

Marillyn Hewson

Good morning.

Myles Walton

First of all is a clarification. I might have missed it, but the international sales in 2014, I think the last two years have been about 17% of sales, but you can just give that number for '14.

And then, Marillyn, as you look at the Middle East as kind of a customer base and you think about the threats that exist there, that's one aspect, but the foreign policy and what we choose to do there is another.

Just hypothetical if the U.S. does move more towards the normalization with Iran over the nuclear activities, does that in any way impede which you see as progress not for our military sales-front there from a dealer's perspective. Thanks.

Marillyn Hewson

Thanks, Myles. Well, first an answer to your question, we achieved 20% of our total sales of an international sales in 2014. So we're pleased with that and we have over $20 billion in our backlog at year-end of that.

We've set a new goal to get 25% over the next few years. Our growing international area is an important element of our strategy and growth for the company, and we see a lot of expanding demand for international growth, expanding demand on missile defense, on aircraft programs on a range of things.

To your question about foreign policy and normalization and things of that nature, in my discussion with our customers that really isn't coming up. I mean it's very clear to the Middle East region that that dialogue is going on.

But, front and center for them are the needs they have today, what their critical national requirements are today. So, our discussion is that -- is around those national security needs that they have and there're certainly plenty of threat in the region.

Just the volatility, even if there're maybe some kind of deal done with Iran, there is volatility all around the region. And each one of these countries believes they've got to protect their citizens and the things that we can bring to them help in that regard.

So similarly, that's the Middle East and I know that's what you asked about, but you could take that same argument to the Asia-Pacific region, which is another growth area for us.

A lot of volatility, a lot of instability, a lot of things that are happening both with North Korea as well as some of the tension between China and Japan and -- so in both of those regions which are growth areas for us we expect that there's going to continue to be opportunities for us to bring our capabilities to them.

Operator

Thank you. Our next question is from George Shapiro of Shapiro Research. You may begin.

George Shapiro

Yeah. Bruce, I noticed that all the margins that you project for '15 in each of the sectors are down relative to '14. Now, Aero is explainable with mix, space maybe explainable with less venture income. But can you go through why they are down in all the other sectors?

And if you could maybe lay out what you think would be kind of the normalized number that we'd wind up reaching in terms of these margins, because it will be the second year that we'll have seen a decline.

Bruce Tanner

Yeah. George, I'll try to take a shot at. That’s a good question. So, even though you kind of gave the answer for a couple, I'll go ahead and try to hit all five business areas from my perspective, maybe from what we're seeing in 2015 and then sort of a longer term view.

So, Aeronautics in '15 in part because of all the discussion we've had up to this point on the F-35 production part and the fact we expect to see some increases there. F-15 -- 2015 is really looking fairly comparable from margin perspective for Aeronautics.

Longer term, we've talked about the fact that as F-35 increases, even in the scenario that I described with year-over-year margin increases, those will still be lower than the composite average margin for Aeronautics, if you will. So that will still be dilutive just because of the growth of the F-35 program. And that's what we expect to see their longer term.

Missiles and Fire Control is may be slightly lower, but -- than 2015, but I'll say that's probably pretty comparable when you look at it big picture wise and we still think we have some of the same opportunities in 2015 as we had in 2014.

Longer term, I would expect some reduction in higher margin business that we've got there particularly if we're successful for instance winning the Joint Light Tactical Vehicle, you would expect us to have that program start off at a lower booking rate than some of our legacy long production programs, long production missile programs, out of missiles in Fire Control.

And so I would expect to see again longer term some reduction in the margins in missiles and fire control from the level we experienced in '14 and probably '15 as well.

Mission Systems and Training is down slightly in '15 compared to '14. You should think of that really primarily as a result of new program starts. So programs like Space Fence, like the combat rescue helicopter, like the new presidential helicopter; those are all early starts on larger programs that are actually driving a lot of the organic growth of MST there.

And that's coming with lower margins than some of their heritage production programs just like I talked about on Missiles and Fire Control.

There is also within MST in 2015, some of the last of the restructuring charges that remember we talked about in 2013, we took the severance charges, but there were still ongoing restructuring charges for things like facility closures and facilities rearrangements and so forth.

There is about $20 million or so higher restructuring cost in MST in 2015 or 2014. So that's putting a little bit of pressure there. Longer term, I think it's going to be fairly comparable to where we end up 2015, maybe a little bit higher if some of that restructuring expense goes away and hopefully we start to have some increases on some of those early program starts that I talked about.

IS&GS we teed up in the October call that we thought it would be down about 30 basis points or so from 2014 to 2015 and I describe that as about half of that just being sort of the increased level of competition, recompute, disaggregation, breaking down contracts and so forth.

And the other half of that 30 basis points was we changed some of the backlog with an IS&GS to have an number of longer term international programs that extend over multiple years a little bit different than sort of the heritage IS&GS business and those were starting off just as any new program with lower overall margins of the composite and that was sort of the other half of the 30 basis points that we talked about.

So if you rewind back to the end of the October call, it would have said, we should be looking at probably somewhere in the 87-88 range for margins at ISGS. We're little lower than that and all of that George is because of the transaction expenses associated with the acquisition we made at the of last year for systems made simple.

So that's bringing another 30 basis points or so reduction to IS&GS' overall margin. So while that acquisition is EPS dilutive, it is actually cash accretive in year one. So that's something we're happy to take those charges and again longer term, for IS&GS is that as those transactions cost start to play out, expect to see some slight increases in the IS&GS profitability margin levels from where we are today.

In Space, you talked about -- the earlier earnings we teed that up in the October call that the equity earnings associated with the United launch alliance are down pretty considerably. In 2014 versus 2015 a lot of those is just the mix of the launch vehicles we have there and that's driving the biggest single piece of that.

The other piece that may not be evident again is we also made couple of acquisitions for data and the satellite processing business that we acquired last year. Those also are bringing transaction expenses in 2015 that were not in 2014. You should think of that as about a 20 basis point or so impact in the margins of space systems company in 2015.

And just as I described on the systems made simple or the acquisition for IS&GS, while they are a little bit EPS dilutive in 2015, both of those acquisitions are cash accretive in 2015. So we're happy with that.

Longer term, for Space Systems, I think we get back at about the 12% margin, we're a little bit like to that in 2014, but as some of these -- again transaction expenses go down and by the way some of the restructuring cost that we have in Space System start to wind down, I think you'll see the overall margins getting back to sort of a normal run rate with the ULA equity earnings at about the 12% level.

Jerry Kircher

Shannon, this is Jerry. I think we've run over the hour a little bit. So I'll turn it back over to Marillyn for final comments.

Marillyn Hewson

Sure. Thanks Jerry. I just want to wrap up the call by again saying that the corporation achieved another excellent year in 2014 and we continue to be well positioned to deliver substantial value to our customers and our stockholders as we moved strongly in 2015.

So thanks again for joining the call today. We look forward to speaking to you again in our next earnings call in April. Shannon that concludes our call today.