Good day. And welcome everyone to the Lockheed Martin Third Quarter 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 third 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 facts are considered forward-looking 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. Thank you for joining us on the call today. As we review our financial results and key accomplishments in the quarter, as well as provide a brief update on some of our strategic initiatives. As today’s release detailed, we continue to drive towards achievement of our full year goal with another quarter of solid operational and financial results.

Although, we continue to face global economic challenges, these results reflect the execution across all of our businesses as the Corporation continues to operate a very strong level in returning value to stockholders, while providing critical solutions to our customers. The daily focus and efforts of our team are the foundation of our ability to deliver broad-base results across the Corporation and I thank them for their ongoing contributions.

Turning to our financials, while, Bruce, will cover the results in detail later, I want to particularly highlight our continued exceptional cash generation. This quarter we achieved approximately $1 billion in cash from operations, bringing our September year-to-date cash generation to over $4 billion.

Strong cash generation is a longstanding hallmark of our Corporation and continues to be a differentiator, as we return cash to stockholder through dividends and share repurchases, while also making appropriate investments in the business.

Our strong and growing cash generation enabled by our Board of directors, enabled them to approve two key cash actions this past quarter. First, we increased our quarterly dividend to $1.50 per share and $6 annually. This action represents the 12th consecutive year that our dividend rate has been increased by double-digit percentages.

Second, we also increased our share repurchase authority by $2 billion, bringing our total current share repurchase authority to almost $4 billion and providing additional flexibility to continue to make future share repurchases.

Beyond the Board actions, we recently completed our Annual Financial Planning process and projections of future financial metrics. I'm excited about the robust cash generation that the plan projects going forward and our ability to implement strong actions to deploy cash back to stockholders.

In light of our future projected cash flows, we are implementing a new cash deployment initiative in which we anticipate reducing our total outstanding share count to below 300 million shares over the next three years.

Share repurchases of this magnitude, coupled with our dividend payments would results in our returning vast majority of annual free cash to stockholders over the next three years and continue our longstanding strategy of disciplined cash deployment and value creation for stockholders.

Moving to operations, while numerous mission success events were achieved across the Corporation, I want to highlight two major events achieved by our Space Systems business.

In September, our team successfully inserted the Maven spacecraft into orbit around Mars. Space Systems constructed the spacecraft for NASA and also provides flight operations control of the vehicle as it surveys the upper atmosphere of Mars.

These surveys will provide vital data to scientist seeking to understand how the loss of atmospheric gas to space changed the Martian climate and potentially provide valuable insight into atmospherics dynamics here on earth.

Another area where key accomplishments were achieved by space is on the Orion program. This quarter the inaugural spacecraft was successfully fueled at the Kennedy Space Center and its progressing towards integration with the Delta IV launch vehicle in November. The program continues to progress and it’s in the final stages of preparation for its initial unmanned test flight scheduled later this year in December.

Orion remains an essential national asset in returning capability of manned access to space to our nation in the coming years. We are proud to be serving as the prime contractor on this program and progressing on this critical capability for NASA and our country.

I’d like to briefly switch to our international activities and provide an update on noteworthy achievements in this strategically important area. Progress this quarter was seen both in new strategic partnerships and new business awards.

In the area of new international partnerships, we opened a new Space Technology Office in the United Kingdom. This office will expand our in-country relationships with U.K. companies, government agencies and universities.

We are looking forward to applying our 50-year heritage of Space Systems expertise to develop opportunities in environmental monitoring, space exploration, global security and secure space communications.

And we also opened a new space object tracking site in Australia to construct a more detailed picture of space debris for both government and commercial customers. This site will use electro optical technologies and will compliment radar tracking systems such as the U.S. Air Force’s Space Fence program that we were awarded last quarter.

Beyond our footprint expansion initiatives, new business awards from international customers this quarter included receipt of an $800 million contract from the Australian Department of Defense to develop a centralized information processing environment. This program will significantly improve the efficiency of data delivery by consolidating the department’s 280 data centers into 14.

Additionally, we were very pleased that the Republic of Korea finalized its formal selection of the F-35 for their fighter replacement program and have announced their intent to sign a Letter of Offer and Acceptance between the

United States and Korean governments for 40 F-35 aircraft. This program is valued at nearly $7 billion for aircraft and associated support activities.

These recent actions and awards are representative of the growing level of activity that our international strategic initiatives are generating. I'm pleased to report that we are projecting achievement of 20% of international sales content by the end of this year, achieving a goal we outlined to you a few years ago.

Growth in international business content is an essential element in our ability to generate future sales for the Corporation. Projected international sales growth will help offset the impact of U.S. government budget pressures on domestic sales levels.

With growing international demand expected for our products, such as the F-35 fighter and missile defense systems, I'm increasingly confident that our annual international sales content could increase to 25% or higher in the next few years.

Before turning the call over to Bruce, I wish to note that we are very proud to have recently been named to the Dow Jones Sustainability World Index and to two carbon disclosure project Climate Change Management Indices.

We are the only U.S. aerospace and defense company to earn a spot on the world index. And our CDP awards mark the fourth consecutive year our Corporation has been recognized for exceptional performance. These prestigious awards reflect our continuing pursuit of sustainable practices through innovation, transparency and sound governance. They also reflect the broad commitment of our workforce that help engineer a better tomorrow.

I'll now ask Bruce to go through the details of third quarter and full year financial performance and our 2015 financial trend preview. And then we'll open up the line for your questions.

**Bruce Tanner**

Thank you, Marilyn. Good morning everyone. As I highlight our key financial accomplishments, please follow along with the web charts that we included in our earnings release today.

Let's start with chart three, an overview of the quarter. As I'm sure, you're aware, shortly after the second quarter earnings call, The Highway and Transportation Funding Act of 2014 or HATFA was enacted. And because this legislation extended the methodology for determining discount rates used for pension contributions established by the MAP-21 Legislation in 2012, it will have a significant impact on our results for the quarter, the year and longer term as well.

We'll describe the impact this had in the quarter below. I will also spend quite a bit of time in upcoming charts describing these future impacts to you.

Sales in the quarter were $11.1 billion in line with our expectations, though down slightly from last year. Segment operating profit was also as expected at $1.3 billion with our segment operating margin remaining strong at 12.1%.

Our net earnings from continuing operations increased 5% to $888 million. And this is where we first see the impacts of the HATFA legislation. The effect of the legislation lowers our FAS/CAS income for the year by slightly more than $70 million and requires a retroactive adjustment in the third quarter amounting to $55 million or $35 million in net earnings. Without this adjustment, net earnings would have increased by 10% to $923 million. We'll see the remainder of the $70 million adjustment in the fourth quarter.

Our earnings per share from continuing operations increased 7% to $2.76 in the quarter. And again these results were dampened by the impacts of the HATFA legislation in the quarter, which amounted to $0.11 of earnings per share. Without this retroactive adjustment, our EPS in the quarter would have been $2.87, up 12% in the quarter.

Our cash from operations continues to be very strong with just under $1 billion generated in the quarter stronger than we'd expected. So I think we had another solid quarter results and we're well positioned to finish the year consistent with our guidance.

If you'll turn to chart four, we'll highlight just how strong our cash from operations has been this year. Our cash generated in the quarter was almost a $1 billion and this represents a 10% increase over our level from a year ago. And on a year-to-date basis, our results were even stronger with $4.1 billion generated in the first three quarters, up 13% over the comparable time period last year.

Chart five shows our cash deployment actions through the third quarter with dividends to-date of almost $1.3 billion and share repurchases of approximately $1.7 billion. We've returned nearly $3 billion to shareholders through the first three quarters, representing 82% of our free cash flow for the same timeframe.

And as Marillyn said in her remarks, we also increased our dividend in the quarter at 13%, the 12th consecutive year, we have increased our dividend level by 10% or greater. This payout level begins with our fourth quarter dividend.

On chart six, we'll explain the impacts of the HATFA legislation enactment in more detail. As I mentioned earlier, the legislation was enacted after the July earnings release and in simple terms, it impacts us by extending the methodology used to determine discount rates for ERISA contributions that was put in place with the MAP-21 legislation.

That methodology was an attempt to recognize the unprecedented low interest environment we were experiencing, which would have required making significant cash contributions to pension plans. The impact of the MAP-21 methodology decreases each year and would have phased out by 2016.

Under HATFA, this methodology will now be extended so that it will begin to decrease in 2018 and phase out by 2021. It has the effect of lowering CAS cost as well as ERISA contributions from what they otherwise would have been, had MAP-21 not been extended.

As you will see the impacts of these changes are somewhat mixed. They result in reduced pension funding requirements in the near term but also low recovery of pension contributions as it lowers our CAS cost in the near term. And while lowering near-term CAS cost improves our overall competitiveness and lowers the required level of customer funding, it also will lower our reported earnings per share in the near term.

I'll get into more specific detail of these impacts on the next page but overall we think these changes provide relatively neutral economic impact while having a negative impact on near-term GAAP earnings.

Chart seven provides more detail into how the HATFA changes will affect our pension recovery and funding requirements over the next three years. And these projections are based on the underlying assumptions for our pension plan as shown on chart 14 in our appendix web charts.

Focusing on the column labeled before HATFA, we were expecting to recover more than $7 billion through our CAS pricing between 2015 and 2017. We also would have had $3.5 billion in required contributions over that same period resulting in a net $3.8 billion in pre-tax pension cash recoveries.

As you can see in the column labeled after HATFA, we now expect to have CAS pension receipts of $5.8 billion while reducing our required pension contributions to $1 billion over this time period resulting in a net $4.8 billion in pre-tax pension recoveries. As you'll see in a couple of charts, we intend to make this required $1 billion contribution in the fourth quarter of 2014, creating a three-year pension funding holiday and allowing additional cash deployment opportunities to shareholders over the next three years.

The bottom two bullets on the chart describe what these changes mean relative to approximately $10 billion of pension pre-funding amount. By 2017, we will have recovered just under $5 billion of that amount and by 2020, we will have recovered a total of just over $8 billion. With this level of pension recoveries, we would expect our cash from operations to be greater than or equal to $15 billion over the 2015 to 2017 timeframe.

On chart eight, we provided our updated outlook for 2014. We're maintaining our orders outlook for the year while we're ahead of our orders planned for the first three quarters. We have the large C-130J multiyear order planned in the fourth quarter which could slip into 2015.

We're providing point estimates for those sales and segment operating profit as we're increasingly comfortable with our ability to achieve these levels. And both of these are above the midpoints of our prior guidance.

We also provided our usual sales and segment operating profit outlooks by business area in the appendix to our web charts today. Our FAS/CAS pension income is lower by about $70 million as previously discussed. But we now expect our other unallocated expenses to be lower by similar amount resulting in $5.6 billion of operating profit.

We are now guiding our earnings per share to the high end of our previous guidance at $11.15 per share which includes the negative impact of $0.14 per HATFA. And with the additional $1 billion contribution to our pension trust this year, our cash from operations is now expected to be greater than or equal to $3.8 billion.

On chart nine, we provide our preliminary look at our 2015 financial trends. We expect our 2015 sales level will decline by a low single digit rate from our expected 2014 level, a little lower than we previously expected.

We had previously thought 2014 would represent the trough year of sequestration's effect on our topline. But that has now moved out a year as we continue to see downward pressure primarily in our services businesses.

We expect our segment operating margin will remain strong at between 11.5% and 12%. Our FAS/CAS pension income rose to about $650 million in 2015, after the affects of the HATFA legislation. And assuming the discount rate remains at 4.25% at year-end 2014, our return on asset is 8% in 2014 and based on the additional $1 billion in incremental pension funding in the fourth quarter of 2014.

Again, that would allow for no required pension contributions from 2015 to 2017. Beyond 2015, with these same assumptions for our discount rate and return on assets, we would expect FAS/CAS income to continue to grow to about a $1 billion in 2016 and $1.5 billion by 2017. And because we are eliminating our previously plan $1 billion pension contribution in 2015, we anticipate increasing our share repurchases to at least $2 billion, about a $1 billion more than the level required to offset the amount of share creep expected during the year. This would be a good start reducing our share count level below 300 million share amount within the next three years that Marilyn mentioned earlier.

Finally on chart 10, we have our summary. Our third quarter and year-to-date performance continues to be very solid. Our results leave us well-positioned to achieve the full year guidance we provided and we continue our long-standing commitment to returning cash to our shareholders.

With that, we are ready for your questions? Shannon?

**Question-and-Answer Session**

**Operator**

Thank you. (Operator Instructions) Our first question is from Carter Copeland of Barclays. You may begin.

**Carter Copeland - Barclays**

Hey. Good morning.

**Marillyn Hewson**

Good morning.

**Carter Copeland - Barclays**

A couple of quick ones. Just first on the sustainment weakness you called out in Aeronautics in the quarter. I wondered if you might give us some color about what that related to and whether that was tied to in-theater operations or something else.

**Bruce Tanner**

Yeah. I will take that one, Carter. So the sustainment weakness in aero was really, I think of it is as predominantly F-16 or little bit in our Kelly business as well. The F-16, you should think of a couple of things going on there. We have a couple of large international F-16 month programs that are starting, but they started later than we had anticipated or they will start later in one case than we anticipated. And while we previously kind of expected to have some existing older mod programs, sort of feather end to these newer mod programs, we now have a bit of lowering point or a trough before we start to see the new programs pick up speed and that's what's driving the numbers stand a little bit in F-16.

On the other hand for the F-22 program, this is a bit of good news, can also be bad news in some respects. We provide the sustainment of the F-22 aircraft in the field, and the aircraft are actually performing better than our expectation and I believe better than the customers' expectations. And so because of that because our readiness levels and the like are higher than we expected them to be at this point in time were actually seeing a diminished level of spares requirement, another sustainment activity to support the aircraft at that level. So while that's terrific news for our products, terrific news for our customers, does result in a little bit of lower sales for us in 2015 than we previously planned.

**Operator**

Thank you. Our next question is from Jason Gursky of Citi. You may begin.

**Jason Gursky - Citi**

Yeah. Good morning, everyone. Hey Bruce, the question for you on the cash flow outlook over the next three years. You are going to do $3.8 billion this year which includes roughly $2 billion dollars in pension contributions that won't be there in the '15 through '17 period. That would suggest on average $5.8 billion and yet you are guiding on average $5 billion in cash flows, '15 through '18. Can you talk a little bit about the puts and takes that are going on with cash flow? Where might we really come on to or where we might we go over?

**Bruce Tanner**

Yeah. Let me try to take a shot at that, Jason. So, I think you are -- the back of the envelope math you did would be exactly right. $3 billion with $2 billion pension contribution why wouldn't that equal $5.8 billion next year? So the short version answer to that is, think of that as primarily cash taxes. So the additional $1 billion that we are contributing in 2014 think about as about a $350 million swing that we won't get that tax deduction, if you will in 2015 and somewhat seems over at this point in time. But we also had a tax refund in the first quarter of this year about $250 million. So between the two of those, think of that as what $600 million-ish or so. I think we've -- the one thing I would add that may help little bit in discussion also is while we are saying greater than or equal to $15 billion, we do expect 2015 cash flow to start with a $5 billion obviously at this point in time. But I would expect that year-over-year our cash from operations would actually increase over that number between ’15, ’16 and ’17. So we are actually feeling good about the statement of greater than or equal to $15 billion.

**Operator**

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

**Rich Safran - Buckingham Research**

Hi. Good morning.

**Marillyn Hewson**

Good morning.

**Rich Safran - Buckingham Research**

Let me ask you a different sort of question on cash flow here. Marillyn, I heard your opening remarks, may just want to get a little specific. Previously your stated goal was to return 50% of cash to shareholders. I recognized you’ve been doing more than that but the $2 billion in share repurchases on the slide, plus the dividend indicates now you're looking closer towards 100%, assuming my math is correct here. So, I want to know if I’m thinking about this right and does it represent a change in your cash deployment strategy? Should we be thinking now that you are going to return more like 100% of free cash flow to shareholders?

**Marillyn Hewson**

Well, you’ve got the math exactly right, Rich. That is exactly how that totals up and so we are indicating to you that we are going to be returning more cash to the shareholders over the next few years. As Bruce just outlined, we are going to have good solid cash flow and so we intend to be -- as we look back, we have been providing more than 50% for the last few years but we intend to continue to do that. So we continue to expect, still expect to have strong dividends. We still -- as Bruce as outlined, we are progressing toward share level, outstanding shares of 300 million. Bruce, do you want to add anything to that?

**Bruce Tanner**

Yeah, Rich, maybe just a couple of moving pieces that may not be readily apparent there. So we have about -- we are probably in the year about 316 million shares or so outstanding. And so we also have, at the end of the year or as we sit here today about $6-ish million -- excuse me, 6 million options outstanding as well then we would expect to be exercised over the three year period. Plus as you know, we provide executive compensation, RSUs, plus matching our 401(k)s and the like that will probably add another 10 million shares or so.

So if you just think of it in terms of what the absolute number of shares would have to be there, it's probably the 16 million shares to get down to 300 plus, some of the creep we just talked about so. At least as we look at, we look at our operating cash flow over the next three years, I think your math is pretty much spot on. It does pretty much require us to do about a 100% of free cash flow over the next three years and that would be our intention.

**Operator**

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

**Noah Poponak - Goldman Sachs**

Hi, good morning, everyone.

**Marillyn Hewson**

Good morning.

**Noah Poponak - Goldman Sachs**

Bruce, if I assume every segment, except IS&GS, has the same topline rate of change in '15 versus '14, as it did in '14 versus '13. I would need IS&GS to be down about 10% just to get the total company down 1% and the low-single digit comment suggest, it could be more than 1%. Is that kind of the rate number for IS&GS next year? Or is there another segment that is incrementally worse than what you previously thought for '15? And if you could just give a little detail on why IS&GS is still dragging at that kind of decline?

**Bruce Tanner**

Yes. So let me give -- maybe just go around try to touch on all five business areas at least at the topline, Noah, because I think you are not quite right in the way you did the math to come up with that number.

**Noah Poponak - Goldman Sachs**

Okay.

**Bruce Tanner**

So I think IS&GS, if we look at '15, it'll probably be down mid-single digits, maybe slightly more than that. And that's probably pretty evenly split between our civil and the defense and intelligence lines of business there. And what we're seeing there is, this is a portion of our portfolio that has always been -- I should start with that, but always has been and seemingly has gotten increasingly competitive in nature to the point where we're even seen sort of our follow-on contracts where we're the incumbent and we won the follow-on contract. Those are being awarded at lower levels than the prior contract were being awarded at.

We are also seeing the disaggregation of some contract opportunities and the sort of multiple elements of that contract that enable additional competition. So that's a little different environment than we had expected to be in, as we're trying to forecast what 2015 would look like a year ago, but that's the reality of where we are today. I think the piece that you're probably missing a little bit is, we are going to be down somewhat in Missiles and Fire Control, probably more than you're expecting.

So Missiles and Fire Control see in total is probably going to be down about a similar amount like, maybe a little bit less than IS&GS and most of that is because we do have a pretty good size services business within the Missiles and Fire Control or technical services business. And that is also experiencing the similar sort of hypercompetitive elements that we are seeing over an IS&GS and so that's going down. We are also down slightly or expect to be down slightly in 2015 in our air missile defense volume. This is both PAC-3 and THAAD. And that's just simply reflecting the lower quantities of missiles that were left a couple of years ago if you will kind of in the sequestration timeframe that are playing out in 2015.

I think Aeronautics is probably, and I think you got this right, Aeronautics is probably pretty comparable to where we will finish 2014, although that's probably a little lower than we had expected it to be primarily for the reasons that I described to Carter's question. I will point out that may not be clear. We are down. We always were expecting to be down in Aeronautics for F-16 deliveries from about 17 in 2014 to about 11 or so, so think of that is like one a month of F-16 deliveries next year. And that combined with the sustainment activity I mentioned the Carter is the reason that we are actually seeing a flat, I'll try to make this simpler before my voice quivers here, that we are making a flat year-to-year situation was what sort of lost and all that as we have a pretty significant reduction in SDD on the F-35 program, but the F-35 production program is drawing a faster than a 10% rate from 2014 to 2015.

Space is down slightly. Next year you should think about as sort of low-single digits, that's primarily because we had two launch vehicles that we recognized the sales for in 2014. We will have no such launch vehicles in 2015. We also had slightly lower government -- we actually have one launch vehicle, but we also have the Orion ETF, which is yet to take place that will take place in December of this year. So that's a higher volume for Orion as well compared to 2015.

We also have lower government satellite volume expected next year, and that's partially offset by the volume from our Zeta acquisition, but net, net Space is still down. And then lastly, the one kind of outlier in all that discussion is MST. And we are actually expecting MST to have potentially a little bit higher sales, maybe a low single digit to higher than last year and you should think of that is primarily because of the new start activity on some of our programs, such as the spacecraft program, the combat rescue helicopter and the presidential helicopter. So hope that gives you a little more added color there.

**Operator**

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

**Joe Nadol - JPMorgan**

I would like to hone in on the F-35. It looks like your margin on the LRIP contracts in aggregate was down a little bit year-on-year for the second straight quarter. I was just wondering if you could highlight kind of what your expectations are there. Is there any risk reduction activity possible in Q4 and going into next year? And maybe just more qualitatively comment on what's happening? Thanks.

**Bruce Tanner**

Joe, I will take a shot at that. So I think the primary reason that F-35 looks that way is we actually had some risk retirements in the year before that were not replicated in 2014. And we are obviously booking those now at the higher rate that resulted from those step-ups in 2013, but we have no similar level of step-ups in 2014. Actually as we look at 2015, I think the F-35 production volume in part because we do expect to make some step-ups next year that we didn't have in 2014. We would expect to see the production volume or production return on sales actually increase next year as opposed to decrease.

So we are slowly getting there and it's a bit of a slog to kind of go, take a program as large as F-35 from a development to a low rate initial production to a full rate production program, but we're getting there. And those step-ups depend on risk retirement events and the phasing of those things changes practically with every single lot. I am happy that we just finished all the F-35 LRIP-5 deliveries and we are going to start delivering LRIP-6 aircraft this quarter.

**Operator**

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

**Doug Harned - Sanford Bernstein**

Thank you. Good morning.

**Bruce Tanner**

Good morning, Doug.

**Doug Harned - Sanford Bernstein**

On Missiles and Fire Control, when you look at the next year and backlogs were down in this quarter. You talked about the service part of this, but if you look at the sort of the broader business, both not service, but both the US and international since that's a big part of it. Can you talk about how the backlogs look for those pieces? And if you're seeing the order flow come in and the timeframes that you would have expected to, are we going to see those parts of the business up some in 2015?

**Bruce Tanner**

Just to be clear Doug, are you talking Missiles and Fire Control by itself and sort of the international content there?

**Doug Harned - Sanford Bernstein**

Yes. Missiles and Fire Control, if you considered the services portion of it, the US equipment portion of it, and then the international part, how are those moving in terms of orders and when we should see the revenues from those orders?

**Bruce Tanner**

Yes. So Doug, as I said previously, the technical services piece is definitely going down and accordingly the backlog associated with business going down, that's almost all US dominated services, if you will. The international business is expecting to increase both backlog and sales going forward. We have already got. In fact, hopefully you saw there is -- today's announcement we had the turret contract for the UK Scout vehicle. This is a subcontract arrangement to actually our facility in the UK was awarded today, that's worth about a $1 billion, that will be recognized as an order in the fourth quarter.

We also had the PAC-3 order for the Government of Qatar that occurred in the quarter. It's already happened. And that's about a $0.5 billion. And as we look forward, there is slight a few international Air missile, defense activities. Those -- as you can well appreciate, those tend to be lumpy and little bit hard to predict, but we would expect backlog in Missiles and Fire Control to grow in '15 compared to '14 and we would continue to expect the international content both in terms of sales as well as backlog to grow from '14 to '15 as well.

**Operator**

Thank you. Our next question is from Hunter Keay of Wolfe Research. You may begin.

**Hunter Keay - Wolfe Research**

Hi. Thanks for taking my question. Bruce, I think if you could dive in a little bit about talking about the components of some of the margin erosion you're expecting to see next year at the segment level. Is this may be parse it out for us between how much of it is a sort of pricing issue with regard to sort of mix shift? Maybe the customers are renegotiating some fixed price contracts that are rolling off? Are you just going to take some more development work? Or is it more just sort of a volume driven through the efficiency issue?

**Bruce Tanner**

Yeah. I don't think it's a simple deal to one of those, Hunter. So let me -- I probably should have done this but no one asked this question. But let me try to address that here with you. So we're guiding towards at least, the trend information that we provided, we said, we prior come between 11.5% and 12% next year. The biggest reason for that, the biggest single reason for that is we're expecting cost of about a $100 million of lower equity earnings from our United Launch Alliance joint venture.

And you should think of that as being probably about three or so fewer launch vehicles in 2015 compared to what was launched or what's expected to be launched in 2014. And it's also the mix of those vehicles, not every launch vehicle that gets launched by United Launch Alliance shares the same level of profitability. It depends on which vehicle and when that vehicle is actually contracted for.

So again, because of quantities of mix changes, think of that has been about $90 million lower. We're also seeing lower margin expectations back on the IS&GS from the competitive pressures that we talked about early on the sales discussion. So I would expect to see IS&GS margins down, probably 20, 30 basis point, somewhere in that range. About half a bit sort of due to competitive pressures that we see that are affecting the sales as well as the bottom line there.

And probably the other half is -- this is probably a little bit of good new story. The other half of margin pressure comes because we've won quite a few large international multiyear contract. So think of this as programs like for the Australian Department of Defense we're providing the IT services for them. Think of it as a number of command-and-control programs for international customers.

And whereas, the vast majority of IS&GS business tends to be very short cycled in nature, these are a little bit more longer term contracts. And as you might expect, we'll start booking those contracts at lower profit rates in part because our new customers and they are longer duration contracts as well.

I'll also mention that we had about $50 million of higher expenses next year 2015 because of intangible amortization and transaction expenses associated with the deals that we're closing this year. And we also have within that $50 million, about $20 million or so of research and development expenses that are hitting the bottom line for Sun Catalytix R&D efforts. This is -- you may have read about this. This is sort of our energy storage pre-revenue kind of business that we acquired.

It does require some continuing R&D expenditures and this is non-far, non DOD business for the R&D hits the bottom line. So collectively again, between transaction expenses in Sun Catalytix about $50 million higher next year than last year. Despite that, I actually went back and looked at what we provided last year at this time. In last year for 2014, at this time we were guiding towards about 11.5%.

I'll say the same thing this year that I said last year, which as I look forward, I think we have similar levels of opportunity to do better as we did in 2014 as we said here looking at 2015. But we have to make those happen and that's the reason we have made those happen yet and we'll see how that progresses throughout the rest of the year.

**Operator**

Thank you. Our next question is from John Godyn of Morgan Stanley. You may begin.

**John Godyn - Morgan Stanley**

Taking my question, Marillyn and Bruce. There is no doubt that Lockheed has a differentiated core competence in aerospace. And particularly if you assume that you win the Long-Range Strike Bomber like we do. But when you look out a few years, at certain point you have effectively tapped out of the organic growth opportunities that the air force so to speak has to offer.

And I wonder if you could talk a bit about how you see the shape of the company evolving in the longer term? Where do we find the growth from there? Do we start looking more closely at M&A, or do we evolve more into sort of a pure cash return vehicle? What's next?

**Marillyn Hewson**

Well, I think, as you talk about the outlook for aircraft and aerospace in general, it's still very positive for us. We're going to continue to see F-35 growth well into the future. I mean, we often talk about how it's very similar to the F-16 program. Today, we have a program of a record of over 3,000 aircraft and the F-16, we sold something like 4,600 of them and we still have continued demand for the F-16 and that's how we expect the F-35 to go.

So, well, there is a program of record with the U.S. government on the number of aircraft that they're going to buy. We have a lot of interested countries internationally that have yet to come online in that procurement process. A lot of partners as you know, eight partners around the world, now three SMSS customers with Israel, Japan and now South Korea and we expect additional customers. Plus some of those customers are early on and what their needs are and I expect that they will look at additional trenches of aircraft over time much that as they do with the F-16 program.

So we'll continue to be a strong aerospace company going forward into the future. They would be a major element of our business. Likewise, the missile defense arena is going to be a continued demand, that's a very important element of our business and there is strong demand internationally. Even as we look at our needs domestically, we expect there to be additional opportunities to use domestically but if you look at FAD, PAC-3, Aegis, Aegis Ashore, even MEADS we expect going forward.

Another area that we are moving into and have invested significantly and have a tremendous product for is the Joint Light Tactical Vehicle, that's a big opportunity as we look forward. Littoral combat ship and the work that we're doing in that arena, there is interested international customers for that. In fact, we just launched the latest LCS at Marinette Marine this past week and we had international customers that attended that ceremony, so they're interested in our products.

We think there will be a demand for that as we go forward to C-130J. That aircraft continues to be in demand. We've got a solid backlog of aircraft and we expect that they'll continue to be others. And now as we've rolled out our commercial version, we expect those commercial customers that today are flying L-100s, to fly the LM-100J in the future. So that will -- we'll continue to look at variance of the C-130J, just as we have for many, many years going forward.

So, I kind of walk through on some of the top products in our portfolio. But as Bruce mentioned earlier, big opportunities in mission systems and components on various other platforms such as the combat rescue helicopter or the Presidential Helicopter, the MH-60 Romeo that we are selling around the world, that we do the mission systems for, out of our mission systems. Simulation and training continues to be a strong demand for that and overtime they will continue to be. And as you mentioned, our tuning with Boeing on the Long Range Strike-Bomber, we expect -- we are very well positioned to win that opportunity.

**Operator**

Thank you. And our next question from Rob Stallard of RBC Capital Markets. You may begin.

**Rob Stallard - RBC Capital Markets**

Thanks so much. Marillyn, a question for you. There have been some comments out of DC that maybe the U.S defense industry is not investing enough its own money in R&D and perhaps returning too much money to shareholders. I'm wondering if this is a comment that you have heard from your customer and how they might respond to your latest announcement today on the buyback.

**Marillyn Hewson**

Well. Yes, we have heard that from our customers that, a concern by our customer that we lose our technological superiority in this period of time when there are budget pesters and it's a down market. I would tell you from the Lockheed Martin standpoint, we have increased our R&D from last year to this year by 13%. We are going to increase another 5% this year or so and we will continue to. So we are at the highest percent of sales that we've ever been in terms of our research and development and we will be hiring in 2015.

We will continue to invest. But I do think an open communication with our customer, especially in the Department of Defense is really important. And we are in constant dialog with them on what areas that we want to invest and how that aligns with what that they see as their priorities in the future. A lot of our products as you know require a lot of development on the front end such as F-35, or of course we look forward to JLTV that we talked about and a variety of them. So as we come out with products, we are constantly investing but we are investing in new technologies. We are looking at how do we help our customer get an advantage of our adversaries, we have things going on that we can't talk about on this call. But certainly there is a lot of investment in new materials and new capabilities that we think our customers will need.

So, yes, we are hearing it. And I think from the Department of Defense standpoint because they recognized that, I think they will in turn be looking at making sure that they invest in new technology and we expect to participate in that opportunity. We do cooperative research and development with universities and with other government labs as well. So when you look at our percent of IRAD, you have to add to that the things that we are doing there and collaborative CRAD type of things. We are -- we are major provider to DARPA. So the work that we do with DARPA is another example.

So when you total it all up, you can't just look at one number on the balance sheet. You have to take into account the type of work we do, the complexity of the products that we produce and how much research and development that takes on the front end in the development days as well as our independent research development and our work with DARPA and our CRAD.

**Operator**

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

**Myles Walton - Deutsche Bank**

Thanks. Good morning. I was hoping Bruce maybe you could touch on the profit adjustments, not related to volume and kind of what's baked into '15. It looks like maybe for this year, you will be running some where 32% to 33%. And then also if you can just clarify on the sustainability of unallocated expense being at this level? Thanks.

**Bruce Tanner**

Yeah. So, I think you are about right, Myles, I don't quite have the number on my head. But we were a little bit lower in the fourth quarter in terms of our profit adjustments. I would expect that we probably rebound a little bit at least as we look at the planning for the fourth quarter. I mean obviously those can move out if we don't sort of accomplish all the events that we hold to that result in those risk retirements. But as we look here today, we would expect to bounce back up a little bit and that was in the year at about the level you said I mean somewhere probably in the 33%, 34% of total profitability.

I would think next year is probably fairly comfortable. We kind of tossed out the 30% to 35% as sort of where we expect that we were a little bit higher than last year. But that's about what we expect to be going forward. And then as far as the other unallocated, I would not expect it to be quite at the level we are forecasting for this year in part because, I mean, there is a lot of moving pieces in that as you can well appreciate. Though we had some -- we had some question corporate costs that got resolved in our favor during the quarter. There was fairly the largest piece of those moving pieces and I would not expect that to replicate in future quarter so this is a bit of an outlier.

**Operator**

Thank you. Our next question is from Rob Spingarn of Credit Suisse. You may begin.

**Ross Cowley - Credit Suisse**

Good morning everybody. This is actually Ross on for Rob. I was just hoping to get a quick update on the expected timing for the signing of our patent F-35 and any other details you could provide regarding that contract?

**Marillyn Hewson**

Well, I'll update, we are progressing well in the negotiations. So I think that we expect to see a closure on that in the near term. It's for 43 aircraft is what, it's the number of aircraft in that lot. So we'll see larger number of aircraft in our update. We have -- its progressing very well and we had good discussion with the customer and we expect to conclude the negotiations in the near term.

**Operator**

Thank you our next question is from Cai von Rumohr of Cowen & Company. You may begin.

**Cai von Rumohr - Cowen & Company**

Yes. Thanks so much. So, Bruce if you could comment on aeronautical with respect to, I think you took a contract reserve in the third quarter and also may be update us on the C-130 deliveries this year and next year given there was a slip on the F-16 and the implications of that F-16 slip on profitability next year? Thanks so much.

**Bruce Tanner**

Yeah. So actually we had two. We said there are contract reserves that I probably better stated as sort of legal reserves. One was to resolve a legal matter and other was a sort of to create a provision for a legal matter. Two different -- two different items about the same quantity of each of them. So it totaled up $30 million in the quarter. I think we released that in the earnings release.

C-130 deliveries, we do expect to end the year about 24. We are going to run about 24 aircrafts build rates. And you could possibly have one slip here and there between years. But I don't expect that to happen in 2014. We are tracking well to that schedule. And I would 2015 would be a similar level at the 24 aircraft. And then I think your last question was on F-16 and most for the profitability of that because we are losing volume of aircraft quantities obviously the profit dollars associated with those aircraft quantities will go down. I wouldn't expect to see a huge drop-off from margin perspective year-over-year because of that, I mean, the aircraft quantities that are being delivered, I still think we'll have comparable margins and the sustainment activity including the modern work that we do is also fairly comparable to the aircraft business that we have there. So it may not be as self evident as when the quantity drops, the profitability also drops or the profit and the margins also drops. I don't think that's the case there.

**Operator**

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

**George Shapiro - Shapiro Research**

Hi, good morning.

**Bruce Tanner**

Good morning.

**George Shapiro - Shapiro**

Little one's, I'll patch together, C-5 deliveries next year and do we get any chance of getting above the zero margin. And then on the F-35, if you could breakout revenues by the different LRIPs and if there is any international revenue starting to pick up next year?

**Bruce Tanner**

Yes. George, I'll take that one. So C-5, we're expecting to increase the rate, you should -- I think we will do probably six, maybe seven C-5s this year. We're actually performing well in that program. I think we grow that number to about nine, expected deliveries next year, so we'll see some volume increases associated with them. I think there is a chance that we'll see some profitability increases, George, on that. We're performing much better as we performed throughout 2014 towards the end of the year than we were even at the start of the year. And assuming that trend sort of continues into 2015, I think that creates the possibility for that.

I think we talked on a pervious call about there is definitely some what we call over and above work that we think we've entitlement to that we do believe we can get reimbursed at some point time, that is not yet played out. But we continue to believe we have that entitlement, which would allow more than what I'm talking about just through I'd say ordinary program performance improvements year-over-year. So I'm feeling better about the program going into '15 than I was into 2014.

The international revenue on the F-35, it's -- the quantities are going and just roughly I think we kind of pulled out the number, it's a little bit out of off the top of my head, but we're probably somewhere between $1 billion and $1.5 billion in international revenue this year and we'd probably expect to grow that number above $2 billion of the total F-35 revenue for next year. So it's growing at a fairly fast clip by itself. Again the program in total, the production program is growing more than 10% year-over-year from '14 to '15, so internationally we would expect to do that as well.

**Operator**

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

**Gary Liebowitz - Wells Fargo Securities**

Good morning, guys. It's Gary Liebowitz for Sam.

**Bruce Tanner**

Hey, Gary

**Gary Liebowitz - Wells Fargo Securities**

Couple of quick ones. Bruce, for your three-year cash flow outlook, how should we think of capital expenditures over that period?

**Bruce Tanner**

Yeah. So you should think of those as being fairly similar to the level we had in 2014. Gary, we are right at around $1 billion between PP&E, capital expenditures and our capitalized software. And that's about the level we see in the future. It could be a little less than that, maybe a little more than that, but for planning purposes, think right at about $1 billion a year.

**Gary Liebowitz - Wells Fargo Securities**

Great. And my second question and I apologize if you addressed it already. The sales outlook in Space that you took up to $7.9 billion this year, what was behind that increase?

**Bruce Tanner**

Yeah. so we're getting -- again I think at the beginning of the year, we had probably little more conservatism for some of the later in the year delivery events that would have going to occur, including the Orion ETF launch which should be pretty spectacular by the way on December, in the early part of December this year.

So that now we feel highly confident that that's going to occur. That was one of the reasons we're probably little more conservative with our guidance early in the year. We had also made two acquisitions in the year, Zeta Associates which is the larger of two and Astrotech, which is little smaller, but we are getting additional revenue from both of those as well.

**Jerry Kircher**

Shannon, this is Jerry. I think we are coming up on the end, maybe one more question.

**Operator**

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

**Joe DeNardi - Stifel**

Hey, good morning.

**Bruce Tanner**

Hi, Joe.

**Joe DeNardi - Stifel**

Bruce, I'm wondering if you could talk about, given some of the budget uncertainty obviously we've had over the past couple of years is, I think there is more confidence that that's bottoms out in '15. Does that change the way that you think from a cash deployment perspective kind of balancing the dividend, buyback and M&A, and clearly the M&A side hasn't been a big piece of it the past couple of years? Do you see that changing at all over the next few years?

**Bruce Tanner**

Yeah. I sure help, Joe, that we do see the bottom out in 2015. We kind of teed up we thought that was going to occur in 2014 and we were at least a year off there. So as we look today, I think that we do expect that to sort of bottom out for us in 2015 and we get back to accretive growth in 2016. That's kind of what the budget would indicate. I'm watching in particular the FY'16 budget request and whether or not they sort of stick within the sequestration levels or actually potentially based it more on the actual threats than the strategic direction that the DOD needs to go into. I think that's going to be an interesting one to watch.

As far how that plays relative to our cash deployment, I don't see that having any necessarily large impact on how we would think of cash deployment activities. I think we've given a little more insight into that by what we talked about today with the higher share repurchases that we plan over the next three years at least. And as I always say with the dividends, I think our track record on dividends is the best indicator of what we'll do going forward. So I'll probably leave it at that and turn the call back over to Marillyn at this point.

**Marillyn Hewson**

Thanks, Bruce. We will just wrap up now. I want to thank you all for joining us on the call today and just conclude by reiterating that the Corporation had another solid quarter. And we continue to be well-positioned to deliver substantial value to our customers and shareholders, as we progress towards a successful closure of 2014. So thanks again for joining us and we look forward to speaking with you again on our next earnings call in January. Shannon, that concludes our call today.