Good day, ladies and gentlemen, and thank you for standing by. Welcome, everyone, to the Lockheed Martin Second Quarter 2012 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 F. Kircher

Thank you, Karen, and good morning. I'd like to welcome everyone to our second quarter 2012 earnings conference call. Joining me today on the call are Bob Stevens, our Chairman and Chief Executive Officer; Chris Kubasik, our Vice Chairman, President and Chief Operating 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 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 Bob.

Robert J. Stevens

Thanks, Jerry. Thanks, everyone, for being with us today. We'll proceed on the assumption that you had an opportunity to review our releases this morning.

Since we last spoke in April, we've undertaken a fair amount of international travel to talk directly with our customers and government leaders, consistent with our strategy to increase our international work while we rebalance national security spending here in the United States. While all governments are clearly watching the global economic environment, all are keenly aware of growing security challenges.

As we assess our portfolio, we believe we possess the systems, the capabilities, the skills and the resources to support our security cooperation partners around the globe. And I was very gratified to see strong broad-based operational performance in the second quarter throughout the company based on solid execution and discipline focus. We believe our portfolio gives us opportunities to continue to expand international sales.

Relative to the government fiscal year '13 defense budget, the House has marked and committee both the Defense Authorization Bill and all 12 appropriation bills, including defense. And the Senate has marked the Defense Authorization Bill and committee and will likely mark the Defense Appropriation Bill by the end of this month. At this point, however, we do not expect the bills to be in place at the beginning of the government's fiscal year on October 1, but rather have a continuing resolution that will commence on 1 October and likely extend through the end of the calendar year, enabling the Congress to convene a lame duck session after the election where we believe a broader number of very important initiatives like the debt limit extension, entitlement reform tax policy and spending levels together, sometimes referred to as the fiscal cliff issues, will be addressed.

Sequestration continues to be a great concern to us. There is at present very little insight or detailed understanding as to how sequestration will be implemented even though this law requiring an additional $55 billion reduction in both defense and in non-defense discretionary accounts will take effect January 2, 94 days into the government fiscal year. Without sufficient planning information, we have been unable to more precisely estimate the adverse impacts, and have petitioned the administration and the Congress to stop sequestration and replace it with a more constructive process, or if sequestration is to occur, provide the necessary planning information so we can properly and responsibly prepare to act.

I'll be happy to cover these or any other topics in more detail during our discussion but first, let's turn to Chris for the operational report and Bruce for the financials. Chris?

Christopher Eugene Kubasik

Well, thanks, Bob. From an operating perspective, we had a very strong quarter in an uncertain and challenging environment. In the area of new business, we had several multiyear awards that allow us to offer innovative, relevant and affordable solutions to our customers.

In Electronic Systems, the U.S. Navy awarded a 5-year, $1 billion contract to provide more than 200 digital cockpits and integrated systems and sensors for the new MH-60 Romeo and CR helicopters. The Navy will realize significant savings due to the multiyear contracting vehicle.

In Information Systems & Global Solutions, our team continues to build upon their impressive string of competitive wins over the last 6 months. We were previously awarded the National Science Foundation NRT contract and the

DoD Cyber Crime Center contract. This quarter, we won the Defense Information System Agency contract to manage the transformation of the DoD's global data network. IS&GS also achieved another milestone with its recognition as the top IT service provider to the federal government for the 18th consecutive year.

Let me just now turn to some of our key operational achievements in the quarter. Electronic Systems delivered the second Littoral Combat Ship to Fort Worth. Our team successfully completed acceptance trials and delivered the ship to the U.S. Navy in June, 2 months ahead of schedule and under cost.

Our LCS team achieved another important milestone when the Navy's Board of Inspection and Survey completed their review of our first ship, the USS Freedom, and declared the ship fit for duty. I just returned from Singapore, and there was much excitement and anticipation for the USS Freedom arriving next year where it will perform a key role in our new U.S. Defense strategy.

Electronic Systems also continued to expand critical capabilities in the growing area of Missile Defense with intercepted targets by 2 of our systems. Our Aegis ballistic Missile Defense system successfully intercepted a target missile using the upgraded Aegis system for the first time. Additionally, our PAC-3 missile successfully intercepted and destroyed a cruise missile target, demonstrating the unique ability of the system to detect, track and destroy at extended range.

Missile defense is a growing market internationally, and we are well positioned with our broad portfolio of Aegis, Patriot, MEADS and THAAD, along with the related command and control and battle management systems.

In our Space Systems business, the second advanced VHF military communications satellites for the U.S. Air Force has launched, and we delivered 2 commercial Satellites in the quarter.

Let me wrap up with the F-35 status. Overall, the program continues to gain momentum in developmental flight testing, production activities and international interest. Flight test on the development program are progressing at a solid pace. Year-to-date through June, test flights are significantly ahead of plan by 150 flights or 34%, and test points are also ahead of plan by over 900 points or 24%.

Software development is another area of progress on the program. As we've mentioned on previous calls, software development is a critically important element of the F-35 program. We discussed some scheduled pressures during our last call, and I'm pleased to report that we are seeing improvements to the schedule. As a further sell-in to software maturity and deployment, we began flying the Block 2 A software on the first STOVL aircraft in June. This Block is now flying on CTOL and STOVL aircraft.

Production activities are continuing to progress. In our second quarter, we delivered 3 production aircraft. Since then, we've delivered 7 additional aircraft, bringing year-to-date production deliveries to 12. Included in this total is the first international aircraft delivered to the United Kingdom.

In the area of new production contracts, we were pleased with the award of $490 million for long lead on LRIP 7 this quarter. This authorization enables procurement activities to begin for 35 aircraft and add stability to the supplier base and production line.

Internationally, the F-35 program continued to receive strong support. This quarter, Norway announced their initial order for 2 aircraft, which is expected to be followed by up to 50 additional aircraft. After the close of the quarter, Japan reaffirmed their intentions to purchase the F-35 and signed a letter of offer and acceptance to order 4 initial aircraft.

Additionally, international new business opportunities continue to emerge on the F-35. This past quarter, we submitted a proposal to supply 60 aircraft to South Korea. The announcement of the winning aircraft is scheduled to occur before the end of the year. Overall, the program is demonstrating increasing maturity and tempo, and the global F-35 team looks forward to providing this critical asset to our nation and allies.

With current aircraft deployment of 19 operational aircraft to Eglin Air Force Base, including the U.K. aircraft, plus 8 test aircraft at Patuxent Naval Air Station, 6 more test aircraft at Edwards Air Force Base and just over 70 aircraft in production flow, the F-35 program is making good progress.

With that, I'll turn it over to Bruce to discuss our financials.

Bruce L. Tanner

Thanks, Chris, and good morning, everyone. As I highlight our key financial accomplishments, please follow along the web charts that we included with our earnings release today.

Let's begin with Chart 3 in an overview of the second quarter. We grew sales for the company by 3% versus the second quarter of 2011. I'll describe the drivers behind that growth on the next chart. Our segment operating profit margins improved by 60 basis points to 12.3%, and I'll also provide more color on that improvement in a couple of charts. Earnings per share from continuing operations increased by 10%, driven by the higher sales volume and margin improvement.

We generated $845 million in cash from operations while contributing more than $600 million into our pension plans. This amount completes the $1.1 billion in required contributions for the year. And as you saw in our earnings release, we've increased our outlook for operating profit, earnings per share and cash from operations.

On Chart 4, we'll look at sales by the 4 business areas. As in the first quarter, sales were slightly ahead of our expectations with 3 of our 4 business areas growing. Aeronautics grew 1% in the quarter led by additional quantities of F-16 deliveries. This growth was dampened by the labor strike in Fort Worth, particularly on the F-35 program. Electronic Systems had 2% growth in the quarter, driven by our Mission Systems & Sensors business unit, which had higher volume for our Persistent Threat Detection System or PTDS along with higher activity on our LCS and MH-60 programs.

Space Systems had significant growth in the quarter driven by the delivery of 2 commercial Satellites versus none in the second quarter last year. We also had higher volume on the Orion program compared with last year. And finally, IS&GS declined by 4% driven mostly by a reduction in sales for the AMF JTRS program. As with the first quarter, IS&GS's sales reduction was less than we had expected, with continuing growth in our Intelligence line of business, particularly in federal cyber activity helping to lessen the decline.

Chart 5 shows the segment margin levels for each of the 4 business areas. The primary reason for the overall margin increase to 12.3% was due to improvements in our Aeronautics and Electronic Systems business areas. I'd like to discuss these in a little more detail.

Within Aeronautics, there were several factors that resulted in a 13.3% margin in the quarter that warrants additional discussion. First, we reduced our profit booking rate for the F-35 SDD contract from just over 4% to just under 4%, which yielded an inception-to-date $85 million reduction in profit in the quarter. While we had previously assumed a deck-oriented amount for the remaining fee would be earned, this adjustment reduces that amount even more. We made this adjustment as there's currently no plan in place for the government for how over $500 million of remaining fee can be earned, and we are nearing the point where the amount of profit recorded would exceed the amount of fees received to date on the contract.

In addition, we've been disappointed recently with the amount of fee available to be earned for developmental milestones and the government's evaluations of our performance against those milestones compared with our own assessment. Importantly, because of where we are from percent complete basis on the development contract, the vast majority of the profit adjustment affects the current year. The lower rate has little incremental impact on future margins and earnings for Aeronautics.

This SDD adjustment was substantially offset by contractual resolutions on other firms such as the F-22, leaving outstanding performance on our C-130 program, particularly on international contracts, as the principal reason for the improved margin performance in the quarter. And as Chris mentioned, we're pleased with our progress on the F-35 program as a whole.

Looking at the margin for Electronic Systems, the story is similar to Aeronautics. Improved performance on a number of programs drove the higher margin as contractual resolutions offset proper rate reductions on a few programs and severance cost for workforce reductions at MS2.

Within IS&GS, the higher margin results from a slight improvement in our Intelligence line of business across a number of contracts and the reduction in the margin in Space Systems primarily reflects lower equity earnings due to timing in the quarter. Higher earnings associated with risk retirements on the Orion program helped to partially offset the lower equity earnings.

Turning to Chart 6 and earnings per share in the quarter, EPS from continuing operations grew 10% over the amount reported last year, and adjusting our reported EPS for the effects of the FAS/CAS adjustment increases our earnings per share to $2.77 per share.

If you'll turn to Chart 7, you can see our operating cash flow performance in the quarter compared with last year. Adjusting for the higher pension contributions we made this year compared with last, our pre-pension cash flow was more than $1.4 billion. And after considering the strong performance during the first half of the year and our expectations for the rest of the year, we increased our guidance for operating cash flow by $100 million to greater than or equal to $3.9 billion for the year.

On Chart 8, we'll discuss our updated guidance. We're maintaining our sales outlook, although we are updating 2 of the business areas within this guidance level as we'll discuss shortly. We increased segment operating profit by $125 million. We also increased our earnings per share, as I'll detail in the next chart and again, we increased our cash from operations by $100 million.

Chart 9 shows our EPS outlook reconciliation. The segment operating profit increase added $0.25 to our outlook. Several items partially offset that increase, making the net increase to our annual EPS $0.20, resulting in a new range of $7.90 to $8.10 per share.

Chart 10 shows our sales outlook where we lowered Aeronautics by $200 million for the year, primarily reflecting the effects of the strike. About half of the reduction is for lower F-35 volume, and the other half is an expected slip of 3 F-16 aircraft out of 2012 into 2013. Offsetting this reduction is a $200 million increase in Space Systems, reflecting their strong performance year-to-date.

Chart 11 shows our new segment operating profit guidance. Again, the total increase is $125 million with Aeronautics and Electronic Systems both increasing $50 million for the year, whilst Space Systems increased $25 million.

And finally, we wrap up with our summary on Chart 12. We've had an excellent first half of the year, which reflects the strength of our portfolio and the affordability actions we've taken. Looking ahead to the third quarter, we expect sales will be about $1 billion lower than 2011 results, primarily due to decreases in Aeronautics and Space Systems. We expect segment operating margins to be comparable to last year's and cash from operations to exceed $1 billion.

With that, we're ready for your questions. Karen?

Question-and-Answer Session

Operator

[Operator Instructions] Our first question comes from the line of Heidi Wood from Morgan Stanley.

Heidi Rolande Wood - Morgan Stanley, Research Division

Bob, actually, a tactical near-term question and a second strategic question for you, if you don't mind. The Antideficiency Act precludes the government from spending more than Congress authorizes and many contracts are incrementally funded, which means 1 should start affecting 3 and 4Q results. To what extent does the 2012 guidance reflect this, and can you help us understand your key assumptions? Will you pay employees out of profits and assume retroactive authorization or does your guidance presume stoppage of many of your large contracts? And can you touch on which large contracts are most at risk under warrant?

Robert J. Stevens

That's a comprehensive question, Heidi. I think the details of your question highlight many of the specific details that have gone into our requests for additional guidance because there is considerable uncertainty in understanding exactly how sequestration would be implemented and how, for example, unobligated balances might be affected, how those unobligated balances might be applied contract line item by contract line item. Whether or not military personnel accounts will be excluded or included in the total amount to be sequestered because that has a fairly significant impact on the percentage reductions. So I think your question's front-running a little bit of the detail we have. I'm sure that our government customers are thinking about their responsibilities under the Antideficiency provisions, I think they understand that pretty well. And I think the final part of your question was which contracts, particularly the significant ones, might be most affected. And here again, I think the devil lies a little bit in the details of understanding exactly how the across-the-board reductions, perhaps net of funds flowing from unobligated balances versus new obligational authority subject to sequestration will impact our individual contracts. So, of course, we have significant portfolio areas. Chris mentioned Missile Defense, Chris mentioned the tactical aircraft portfolio, our airlift capability, our Space Systems programs. We think some of our classified activity likely will all be subject to sequester, and which programs will absorb what percent of the cost reduction is not yet clear to us.

Christopher Eugene Kubasik

Heidi, I'll jump in on one comment. As Bob said in his opening remarks, we have contemplated or we are contemplating a continuing resolution in the fourth quarter of this year, and I'll say that affects our business areas differently depending on sort of where they are in the life cycle. The one is -- the most impacted is IS&GS typically because it's the shorter cycle business that we have. So I would say we're probably a little cautious perhaps in the guidance that we're giving, considering the fact that we do believe that continuing resolution is likely going to happen in that fourth quarter.

Operator

And our next question comes from the line of Jason Gursky from Citi.

Jason M. Gursky - Citigroup Inc, Research Division

Bruce, I was just wondering if we could talk a little bit about cash and maybe start off with some comments around FAS/CAS and harmonization of that system. I know that starting back in February, you were able to begin raising your rates and including FAS/CAS harmonization going forward. I'm just wondering how that process is going and whether the outlook that you've talked about in the past and the impact that FAS/CAS will have on you going forward, what that kind of looks like. And then just on the cash topic, the use this quarter on the share repurchase somewhat has you pacing below the $1 billion that you've talked about targeting for repurchases. Can you just give us an update on that as well?

Bruce L. Tanner

Yes, sure, Jason. So as far as sort of a current status of how FAS/CAS is going and is it tracking to what we talked about in the past, I would say yes, it is. That law, I think, was signed February 27 of this year. We've already negotiated across the corporation, a number of what we call our forward pricing right agreements that have the effects of CAS harmonization included in them. So I'll say that is sort of a business as usual at this point right now. You've seen -- as we've all seen the effects of lower interest rate through the first half of this year, they're definitely lower probably than where we were at the end of last year. Of course, we don't set those rates until the end of this year, but if we were to set them today, they'd be lower than where we were last year. Our asset returns, I think, are doing actually fairly comparable to what our expectations were. The one thing I think that's changed, Jason, that's important to consider not necessarily this year but in future years is the transportation -- or excuse me, the highway bill that was passed recently, which had a consideration for reducing some of the funding required by ERISA. And that has the effect of lowering the requirements for our ERISA contributions beginning next year. The modeling of that's a little complicated. I won't get into it, but basically think of a band of around the sort of a 25-year average of interest rates. And if you're outside that, if your current interest rate or discount rate is outside of that band and you used the 25-year average, we're definitely outside of that band as we go into 2013, and so we'll use that 25-year average, which is a much higher rate than what we're currently experiencing. That has the effect of -- I think I tried to tee up on the call in the first quarter that we've had ERISA required contributions of more than $2 billion going into next year compared to $1.1 billion this year. That change in the funding consideration change including the highway transportation bill would lower the required contribution to about the level comparable to what we're seeing this year. So somewhere in the 1.1-ish range or maybe a little flexibility there because we haven't quite seen the final rates come out of that yet, so there may be a little bit of play but not much, I would guess. And so this is as we get bigger hits sort of from negative events due to the size of our pension plan, we also get bigger benefits when there are positive events as well. I'll remind you also that the pension, reduced pension brings with it a reduced tax deduction as well. So you shouldn't think of the $1 billion as being a pure cash because there will be less tax deduction associated with that $1 billion less. You also asked about share repurchases, and we are a little bit light to the first half of the year. We've made no change in our commitment to the $1 billion outlook, and I won't expect to make a change between now and at the year end then.

Operator

Our next question comes from the line of Carter Copeland from Barclays.

Carter Copeland - Barclays Capital, Research Division

Bob, you seem to have taken a sort of leadership role for the industry in your comments that you've made publicly about sequestration. I'm wondering what sorts of conversations you've been having with Congress about potential possible outcomes and time lines? And I'm wondering if you can sense any sort of incremental change in language or posture recently that you -- that's detectable or have we made no progress over the last quarter?

Robert J. Stevens

Well, thanks for the question, Carter. I know that many in the industry are experiencing exactly what we are right now, Carter, and that, I think, is best characterized by a huge amount of uncertainty for a long-cycle business like ours to be unable to see 6 months into the future for a pretty dramatic reduction of resources available to our customers, a significant and for us unprecedented. Throughout industry, I think that reaction is similar. I will say the awareness about the more detailed aspects of sequestration, I believe, is growing and has grown. And it's important to remember the sequestration is not just a reduction in discretionary defense accounts. It's also a reduction in non-defense discretionary accounts, which affect lots of civil government agencies. So I believe we're hearing more detailed descriptions from agency heads and leaders in the government about the potential adverse impacts in their ability to meet their mission responsibilities or fulfill their commitments under sequestration. For our part, we are trying to model internally but to be very candid with you, that model is filled much more with our assumptions about what might happen than any detail specifically given to us about what will happen. The facts are sequestration is the law. It goes into effect January 2. It requires $55 billion in each of defense and nondiscretionary -- nondefense discretionary accounts. Beyond that, we're still struggling with exactly how this will impact our business. We are very concerned about the supply chain, particularly small disadvantaged minority-owned businesses. That's what we regard as the edge of that supply chain. I know we're having discussions here about what kind of business we'll have if we are compelled to implement sequestration. I think they're asking if they'll even have a business, will they have an enterprise. So I think there are significant shocks to the industrial base and very honestly, we simply try to describe them to our best professional capacity, not to incite any particular level of over concern, but we are very, very concerned about the across-the-board nature with an automatic trigger, and that's what we've tried to voice.

Operator

Our next question comes from the line of Rich Safran from Buckingham Research.

Richard Tobie Safran - The Buckingham Research Group Incorporated

Just a question on book to bill. So it was about 0.9x, a bit less than the 1x, but still an improvement versus first quarter. I just want to gauge the confidence in finishing the year with book to bill of about 1x, maybe highlight some of the contracts you're expecting to book in the second half. Now also, did I hear say that you thought South Korea would be booked by year end, and is that one of the things that's giving you the confidence?

Bruce L. Tanner

Rich, it's Bruce, I'll take that one. Your assessment of where we are in the second quarter relative to orders is correct. And I'll say probably what's not as apparent in just the absolute numbers reported is we are actually ahead of where we thought we'd be at the second quarter this time. I tried to tee up on the first call that we thought the second quarter would be down a little lower than normal. The results might lead you to believe that that's the case, but that's actually a little better than we expected it to be. We also mentioned that we thought the third quarter would be a higher rebound than we historically have in years past, and we still think that'll be the case. You asked about some of the -- what are the contracts we're looking for. Most of them, frankly, are in the category of what I'll call follow-on contracts or contracts to be left with the new fiscal year. So yes, the ones I'm watching to close between now in the second and the end of this year are the F-35, our 5 contract, getting additional funding in the form of undefinitized contractual action or other means on the LRIP 6 contract. We'd like to close the THAAD, the combined buy of THAAD missiles from the U.S. government as well as the UAE. And we've got a whole slew of new fiscal year contracts that usually pop up in the fourth quarter. Think of that as the fleet ballistic missile and the PAC-3 contracts that'll play there. I think, was there a second part of the question there?

Christopher Eugene Kubasik

Rich, this is Chris. I mentioned South Korea is a competition for the F-35. We were told the down select would be at the end of the year, but the actual contract would be in the latter part of 2013 at the earliest. So that would not be in our orders of backlog in 2012.

Bruce L. Tanner

And, Rich, I don't think I answered kind of the last part of your question, which was what's the confidence level we have for sort of ending the year at a 1.0. I still think as we sit here today, even with all the caveats that we did relative to sequestration and so forth, we've got a fairly good chance of achieving the same level of backlog at the end of this year as we started the beginning of this year.

Operator

Our next question comes from the line of Joe Nadol from JPMorgan.

Joseph Nadol - JP Morgan Chase & Co, Research Division

I'd like to dive a little bit into the -- some of the details on the F-35 contract profit accrual rates. And so, Bruce, you gave a good description of what's going on with SDD. I just want to confirm that essentially, what you're assuming now is that your future fees will be about 4% of future revenues because you're pretty much at a crossover point right now where that's sure looking backward. And then more importantly, over on the LRIP side, which contracts drove the $20 million risk retirement? And where do we stand on specifically on LRIP 5?

Bruce L. Tanner

Thanks, Joe, for the question. I think you had assessed pretty right. The changes that we talked about, I think it's important to note and obviously you understand that very clearly. This is only affecting the development contract. The production firms aren't impacted by that. The production programs typically don't have much, if any, award fee. They're typically kind of cost performance driven, and so that's also different than the rate or the change that we've talked about for the F-35 SDD contract. I made a comment that we were booking higher than 4%, to a little bit higher than 4% going into this quarter. We came out a little lower than 4%, and that's the adjustment that does bring our booked profit down, if you will, below the amount of earned fee that we have at this point in time. The 2 programs on the production side where we had some performance improvements or booking rate increases this quarter were both Lot 3 and Lot 5. And I think as we progress throughout the year, I think I made the comment either last quarter or the quarter before about the number of deliveries, and Chris highlighted that as well in his prepared remarks, and we're going to finalize deliveries of all the LRIP 2 aircraft, all the LRIP 3 and a pretty good portion of LRIP 4 aircraft this year. So typically, as with most production programs, that will give you that the -- give us, excuse me, the opportunity to assess our performance on that and see if it's coming in line with our expectations and enables additional risk retirements. I think there was one other part of your question there, Joe. I've lost track of what it is, to be honest with you, so I'll go on to the next caller.

Operator

Our next question comes from the line of Doug Harned from Sanford Bernstein.

Douglas S. Harned - Sanford C. Bernstein & Co., LLC., Research Division

I wanted to get your thoughts on cost reduction. It's something that you've emphasized quite a bit over the last 6 to 9 months. Can you talk about what you're doing in that area, whether it's overhead reduction, supply chain facilities? And are there certain targets you have and certain progress against those? In other words, is there any way to quantify the kinds of actions you're taking?

Christopher Eugene Kubasik

Yes, Doug, this is Chris. Thanks for the question. We've been focused on the affordability for the last several years, and it really is all encompassing. Let me start with the employees and the leadership team. If you go back a little over 1 year ago, we had our Voluntary Executive Separation Program where 26% of the leadership team was reduced, and that was over 600 people. Of course, there's the flow down impact of that. We're looking at the layers, we're looking at the span of control as it relates to the personnel and the organizational structure. And we're continuing to look at how best to organize. And you'll recall a couple of years ago, we exited the Eagan, Minnesota facility, we consolidated Owego onto MS2, all those things are on the table. We've focused quite a bit on facilities and our actual footprint. We've taken out over 1.5 million square feet of our facilities, both owned and leased. We have another 2.9 million to go that we've identified and obviously, if there were further cuts to the budget, there could be significantly more reductions. And the supply chain you mentioned, clearly that's an area that we focused both internally with category management as we call it, consolidating our suppliers and holding them accountable for the quality and timely delivery. So I see some of these as being shorter term, some midterm and then, of course, we're always looking out on the long term. And you know back in '06, we placed our defined benefit pension plan with defined contribution pension plan. And that will, I think, position us well for the long term. So that's just kind of an overview of what we're doing. I think when I last looked, you can easily calculate several billion dollars of reduction that we benefited from and that we passed on to our customers as a result of these actions.

Operator

Our next question comes from the line of Peter Arment from Sterne Agee.

Peter J. Arment - Sterne Agee & Leach Inc., Research Division

Question, I guess either Bob or Chris, really want to focus on Information Systems and -- or IS&GS. Just regarding we've seen the most erosion there in terms of the backlog, and I get it regarding being impacted by the CR. But I guess following up on Doug's question in terms of your ability to reduce costs and preserve margins there, you've done a nice job at net 9%, but we're still seeing that's the only segment that's not growing. Can you give us a little more color on that? We're hearing about a lot of predatory practices amongst your peers in terms of bidding contracts pretty aggressively about preserving those margins.

Christopher Eugene Kubasik

Yes, Peter, it's Chris. Thanks for the question. I guess we were very satisfied with our margins in IS&GS this quarter, and we seem to have been able to maintain at or around 9%. Relative to top line growth, you're right. We are experiencing some decline there. It's not unexpected for the reasons that Bob and Bruce mentioned and you suggested in your question. We will continue to bid what we think are appropriate business cases for our business. And I must say we've been very successful on winning some significant opportunities of late. And the protesting is continuing, probably more so than the predatory bidding practices. So I think we have 3 major wins currently under review that we had previously win. So our strategy is to win all the business we can at the appropriate returns. We'll let the 100-day protest cycle run out, and then we will move forward. So I have very high confidence in our ability to execute on these programs. We're hitting all of our milestones. But as I look forward to additional growth opportunity, we're really focused on Cyber Security, and I mentioned that we won the -- what was referred to as the DC3 contract. That was the largest Department of Defense cyber contract awarded to date. We have numerous engagements with Fortune 100 corporations, and we're also continuing to look in health care, IT and the energy lines of business as additional growth areas. So I think we have a good strategy. We're executing on it, and I'm optimistic that we'll find a way to grow over the long haul.

Operator

Our next question comes from the line of David Strauss from UBS.

David E. Strauss - UBS Investment Bank, Research Division

I guess this is probably a question for Bruce. You obviously benefited from a significant amount of positive contract adjustments in the quarter. Could you talk about what the guidance for the year assumes for positive adjustments, and which business areas have the biggest opportunity for positive adjustments moving forward?

Bruce L. Tanner

Thanks, David. I think I said at the start, I lose track which quarter I made these comments on, but I think I said in the first quarter that we were looking at 2012 to have maybe comparable levels of performance improvements as what we saw in 2011. And we actually saw a pretty big increase in those performance improvements mostly coming in Electronic Systems in the first quarter. In the second quarter, we had some good performance, both particularly in Aeronautics and Electronic Systems, also Space Systems on the Orion program, as well as the contractual resolutions that we mentioned that also caused us to come in higher than what we've started at the beginning of the year or expected at the beginning of the year. Our expectations for the second half of the year are probably to be down a little bit compared to the second half of 2011. But again, as we get into the quarter and we actually do our assessments of where we stand on program performance, that's when we would have unexpected both performance improvements, as well as potential reductions in profits rates. But from a planning perspective, as we sit here today, we expect it to be a little lighter in the second half of the year compared to 2011 and by definition, lighter in the second half this year compared to the first half of this year.

Operator

And our next question comes from the line of Robert Stallard from Royal Bank of Canada.

Robert Stallard - RBC Capital Markets, LLC, Research Division

Bruce, just a quick follow-up on the pension. I think previously, you said you expected the FAS/CAS charge next year to be roughly half what you're booking this year. Has that situation changed given the moving metrics of contributions, interest rates and the new legislation on ERISA contributions?

Bruce L. Tanner

Yes. We're probably about 6 months before I'd like to have this conversation, Rob, but definitely, as I said earlier, interest rates are down. If I was to put a number on it, they're probably down about 75 basis points on a year-to-date basis. Your guess is probably better than mine at this point as to what they will have or what they will do between now and the end of the year. You're right on the quantification I've given in the past, all that assumes, as I'd like to call it sort of current course and speed with the same level of discount rate as we ended last year and an 8% return on assets. Again, as I mentioned in the earlier remarks, I think our asset returns are actually holding pretty steady to that level. But the discount rate, if we were to pick it today, would be lower than what it was the end of the year. That would have the tendency to increase FAS, which would make a smaller drop. I still believe it would be a drop at this point from the FAS/CAS adjustment from 2012 to '13. There'd be a lesser drop.

Operator

Our next question comes from the line of George Shapiro from Shapiro Research.

George Shapiro

Bruce, if I take a look at the guidance you have for the second half of the year, you're assuming maybe flattish revenues with the first half and a 10.9% or so margin. I guess that's consistent with David's question about what's embedded in the second half of the year for ECAs. But my question is if you go back to last year and your prior years, it's highly unusual for the second half to have a much lower margin than the first half and yes, that's what's being projected. So is there something else that's in there besides the comment about assuming no incremental ECAs?

Bruce L. Tanner

George, let me try to address a couple of things I think embedded in your question. One is just the second half versus the first half in general, and then I'll hit on the margins especially. Yes, I've taken a look at where we sit today and what our expectations are relative to the guidance we provided for the second half versus where we sit today. There's a couple of things that happened in the first half of the year that won't repeat from a revenue side in the second half of the year. The first of those is again, we had 2 commercial Satellites in the first half of the year, and we're expecting no commercial Satellites in the second half. Think of that as probably a little less than $300 million or so that won't be repeated. Within Electronic Systems, all 29 of the Persistent Threat Detection Systems or PTDS systems that were under contract actually delivered in the first half. So that contract is essentially finished, there will be no PTDS deliveries in the second half. Think of that also as in the $300 million range. So there's sort of $600 million of pressure going from the first half to the second half of the year. We also have in the second half, probably 9 to 10 fewer F-16 deliveries, second half of the year again versus first half. But that's probably offset in large part, maybe even more so, because we expect to have 4 to 5 more C-5 deliveries in the second half than the one we've had in the first half. So those kind of pushed probably. I think as I look at say, the year, it's easier to understand if you sort of do a sequential quarter-to-quarter, it's easier to understand that. So we did roughly $23 billion of revenue in the first half. And I think if you just went to the midpoint in the guidance, it's 45 5. So you can say if you just double the 23, we're pretty close to the 45 5, but for those 2 items I mentioned previously. I think the issue is that the comparison with the second half for 2011 is a tough comparison. Both the third and fourth quarter of last year were much higher than the first and second quarter of last year. And just for example, we did $22 billion roughly in the sales in the first half. We did $24.5 billion roughly in the second half. So obviously, we tremendously outperformed the second half relative to the first half whereas 2012, as I said before, is going to be a little lighter in the second half. I also said we might be a little bit conservative as we sit here today with the expected continuing resolution in the fourth quarter and the prospects of a sequestration on January 2, but we'll see if that actually changes and we'll update accordingly. Relative to the margins, George, you said we don't have a tendency to have a lower second half than the first half, and I'll tell you that's -- we'll still try to make that come true. But we've had, again, just taking a look at the increased profit rate adjustments, as well as the contractual resolutions that we had happen in the first half of the year, our expectations as we sit here today is that those won't replicate at the same level for the same reason I told David in the second half. And that's what will drive margins. Again, maybe a little bit conservative on the top side, it would drive some EBIT, but I don't know if the margins will change all that much from the second half of the year.

Operator

Our next question comes from the line of Sam Pearlstein from Wells Fargo.

Samuel J. Pearlstein - Wells Fargo Securities, LLC, Research Division

Can you talk a little bit just about something around the cash flow, which was around the continuing resolution last year? You certainly moved to build cash levels and seeing the buyback activity weakened, I guess the first piece is are you doing that now? And second piece is does that have any implications for how we should be thinking about the dividend decision that the board typically takes in September where the last few years, we've certainly seen an acceleration from 10% growth to 20% to 30%? How should we be thinking about the appetite for an increase this year going into potentially sequestration and continuing resolution?

Bruce L. Tanner

Thanks, Sam, this is Bruce. I'll try that, and Chris or Bob can pile on if they want to. I think as far as cash balances are concerned, we probably are going into the second half of the year with a little higher cash balance than we might otherwise have expected. And I think we're trying to be mindful of what could happen under both the continuing resolution, as well as the potential CR. And again, our position is we don't want to induce behaviors that would cause program performance issues, cost growth, if we can avoid those perhaps with some balance sheet help. And so we're mindful of that. And again, I think we want to have the flexibility in order to accommodate that. We don't see, as I said earlier, I don't see us backing off the $1 billion share repurchase. That's still our plan and goal for the year. Even though we were a little bit lighter in the second quarter, I still think we're going to achieve that $1 billion number. You asked about the dividends in September. We revisit that every year with our Board of Directors. We've had some preliminary conversations with them, but that's a decision that we'll make in consultation with our board members, and I'd be premature to have that discussion with you right now.

Operator

And our next question comes from the line of Rob Spingarn from Credit Suisse.

Robert Spingarn - Crédit Suisse AG, Research Division

Bruce, on ES, you talked about some of the things that benefited the first half, but that looks like the segment that does retract the most in the second half. Is it -- are you being a little conservative there? And then the other thing I was going to ask is really where I think Joe was going before is just the latest on LRIP 5.

Bruce L. Tanner

I knew I missed that one, I'll catch that one on this one, Rob, and I apologize for Joe. I realized after I went to the next speaker that I missed that one. So ES, second half, again the ES, Electronic Systems is where we have the PTDS. Again, we've got about a $300 million headwind because all those units delivered, as I've said earlier, in the first half. I'd like to think, Rob, that we have a chance to do a little better there. That's yet to play out, and we'll watch that closely. I'll say I've been pleasantly surprised by the performance of Electronic Systems in both the first quarter and the second quarter. Electronic Systems historically and going into the future years always has had our highest international content. I think that there's some still substantial international awards this year that could help us with the sales growth in the second half of the year. But those, as usual, are a little harder to predict at this point in time. So are we conservative? I hope so, Rob, and we'll see as that plays out in the second half of the year. LRIP 5 negotiations, again, I apologize, Joe. We're continuing the process. It is a long process. We've been at it now for at least 1.5 years. So I'll say I think we're making slow and steady progress. I think both sides have a desire to get this closed and to get this closed in the not-too-distant future, and we're clearly on that page that we'd like to do as well. I think we will close in a manner that's beneficial to both parties in the not-too-distant future.

Robert J. Stevens

I'll just add on, on the international front and whether these orders get closed this year or 2013. I personally just got back from a 2-week trip in Marilyn Hewson and all our execs have been increasing their international travel to the Far East and the Mid East. And there is definitely a concern relative to threat environment, and I believe our portfolio and the interest they have in our fighter aircraft, whether it's the F-35 or the F-16, the C-130 everybody loves and of course, our Missile Defense and command and control systems, there is a big appetite out there based on the portfolio that we have. And I believe we have the experience and the know-how and the relationships to do business internationally and to grow. And when they hit the books is to be determined, but I can assure you there's a lot of interest and it's a focus of ours going forward.

Operator

And our next question comes from the line of Cai Von Rumohr from Cowen and Company.

Cai Von Rumohr - Cowen and Company, LLC, Research Division

So, Bruce, could you quantify how big were the cume CAS estimate changes in total in the second quarter, and kind of what are you looking for, for the full year? And then the notional question that you've been at this 30% more or less level for so long, is that sustainable in 2013 and '14 in this current environment?

Bruce L. Tanner

Yes. So, Cai, I think, and I'll stick with what we have in the release, which says we had about $160 million, $170 million in improvement in our profit rate adjustments this quarter compared to the second quarter of last year and again, several performance improvements that I elaborated on already across all 4 business areas, but maybe just to reiterate, C-130 international programs, we had, as you might expect because of the end of the PTDS contract, we recognized some performance improvements on that. We also had nice performance on our vertical launch system. On Electronic Systems, we had, as I mentioned earlier, performance improvement because of a risk retirement for a developmental milestone associated with the Orion crew exploration vehicle. And then on top of that, we had, again I'll say an unusually high level of contractual resolutions that resolved this quarter. And so that's the one that is making the numbers probably a little higher than last year's second quarter. As far as sustainability, you mentioned the 30%. I still think that we're able to maintain that level. If you look back at our history, Cai, we've done that every year. And I look at it again from sort of what is in our planning going forward in terms of planned risk retirements, planned profit rate increases, and I'll say they approach that level today. And where we differ from that level is when we have unplanned beneficial improvements above what we already had considered or when it goes the other way and we have a negative or a decremented proper rate adjustment. Thankfully this year, we've had few of those. Those were offset, again, primarily by the contractual resolutions and were less with the overall performance improvements. So I still see that trend is what was going to happen the latter half of this year and going into 2013 and for that matter, beyond as well.

Operator

Our next question comes from the line of Myles Walton from Deutsche Bank.

Myles A. Walton - Deutsche Bank AG, Research Division

You commented in the release that it would take up the contributions into the second half. Bruce, can you talk about what that's going to look like sequentially into the second half? And also, is that a headwind into 2013? And then to squeeze another one in, the pullback in rates, the disconnect now that exists between CAS and ERISA and FAS, do you think mark-to-market approach on pension expense is making more sense given all the changes that have happened over the last 6 months?

Bruce L. Tanner

Thanks, Cai. You got both ends of the spectrum with your question there. I'd like to try to address -- I'm sorry, did I say -- it's Myles, I'm sorry. Excuse me, Myles. Sorry about that. So yes, I didn't try to write some comments in my prepared remarks about the ULA and USA relative to the equity earnings that we're expecting. We had a little over -- equity earnings in the second quarter, as I said, mostly because of timing issues. And it was actually a nice performance improvement out of our ULA operation last quarter that wasn't replicated this quarter, which made that comparison year-over-year a little more difficult. But this quarter had just lower earnings based on the launch vehicles and the like in the second quarter. We do expect a fairly significantly higher second half of the year relative to equity earnings. Most of that coming in the third quarter. You didn't mention USA, but we're also expecting sort of with the closeout of the United Space Alliance activity to have an additional improvement relative to that equity earnings higher than we've experienced in the first half of this year. So both of those are going to cause, I'll say, a little spike in the third quarter and then will come back down in the fourth quarter, but again, collectively higher in the second half than the first half. You asked about going forward, and I'll say we lose that spike relative to the USA going into 2013 and beyond. But what we're seeing within the Space Systems, Cai, and I've said this on a couple of occasions, is we're getting finished with a number of developmental parts of programs such as the MUOS contract, the SBIRS contract and some others. And we're getting into sort of the sweet spot of production vehicles for all those, and we're doing very well on those. And that performance on the production coming out of the development, as you can expect, the margin improvements associated with that are helping to mitigate the downward pressure resulting from the lower equity earnings next year such that I don't expect a large change in the margins to occur because of that lower equity amount. CAS and ERISA and a lot of moving pieces as you described there in mark-to-market, yes, we've looked at that multiple times. And I'm not sure -- this is why I think I keep preaching that you've got to look through the accounting and get to the economics of it. And frankly, I’d personally favor sort of we all got on the same page there, but I don't know that I see a change on the horizon for us to get to mark-to-market as a company.

Jerry F. Kircher

Karen, this is Jerry. I think we'll come up on the hour. Maybe one more question in queue.

Operator

Our final question for today comes from the line of Howard Rubel from Jefferies.

Howard A. Rubel - Jefferies & Company, Inc., Research Division

Sort of related to what you've talked about in Space and then in one other thing. In Space, you made some management reorganizations, if you could address what that does also in terms of taking out cost? And then can you reconcile -- Bob, you alluded to it that you've had some great performance metrics on the F-35 and yet you're not getting, I guess, compensated for it.

Christopher Eugene Kubasik

Okay, Howard, it's Chris. Let me take the Space question. As I mentioned in an earlier answer, we are constantly looking at our organizational structure and looking how best to streamline and consolidate and get synergies both from a revenue and a cost side. What we basically did there was flatten the organization. And I think we went from about 7 or 8 lines of business directly reporting in to our EVP to 4 or 5. The goal there was to reduce the overhead and the infrastructure to support the businesses. And we also appointed a deputy, Rick Ambrose, a longtime executive with the corporation, to help Joanne as we focus on the strategy and the execution. So the overall goal there was better alignment with the customer and cost savings. And I guess I'll turn it over to Bob here for the F-35 and the wrap-up.

Robert J. Stevens

Yes. Thanks, Chris and Howard, thanks for the question. So relative to the F-35 and our earning potential, we all recognize and you all recognize this is a complex demanding program, really a one-of-a-kind type program that's unfolding in an increasingly tough environment. So we're held to very high standards, and we expect to be held to high standards. We look back at the 18 -- last 18 months performance and found it to be good. We're ahead of our planning. I think we're beating our March, there's much more to go. So we're very realistic about the overall performance. Bruce's comments about the system design and development phase, I think, reflect the reality that we're looking at. But increasingly, our earnings potential will be defined by our ability to produce and deliver the production aircraft lot over lot. And we're very focused on achieving that goal because that's what's going to give our customers the forestructure and the capacity that they need and they expect from us. And so all of us are very focused on the entire F-35 program. We've tried to give the best balanced assessment and accounting of how we expect to earn profit. I will tell you we do expect to earn profit. We think when we deliver high-quality products, that is an appropriate economic response, so that we can share in the value of that performance with the investors in the company. So for all of us, we thank you for your time on the call today. We appreciate the questions; thought they were challenging and good and really insightful about our business. I'll tell you we're all very pleased that the company's remained strong and focused in a really challenging environment. We think that's great credit to the women and men who work here. They exhibit great dedication on a daily basis, and we're grateful to them. We have a really strong portfolio. Chris mentioned his international travel along with our other executives, where we believe we're well-aligned with both global and domestic defense and security priorities. Our backlog, our cash resources, the financial strength of our company provide, we think, a degree of certainty in an uncertain environment as we look to deliver increasing value to shareholders and to customers, and we'll stay very focused on high levels of discipline. And as Bruce said, we'll update you as soon as we possibly can as to these changes in our environment and what they might mean to us. So, Karen, thank you for your help on the call today. Thank you, all, for participating and we'll sign off here.