Ladies and gentlemen, thank you for standing by. Welcome to the Lockheed Martin's Second Quarter 2019 Earnings Results Conference Call. [Operator Instructions] I will turn the call now over to Mr. Greg Gardner, Vice President, Investor Relations. Please go ahead, sir.

Greg Gardner

Thank you, John and good morning. I would like to welcome everyone to our second quarter 2019 earnings conference call. Joining me today on the call are Marillyn Hewson, our Chairman, President and Chief Executive Officer and Ken Possenriede, our Executive Vice President and Chief Financial Officer.

Statements made in today's call that are not historical fact are considered forward-looking statements and are made pursuant to the Safe Harbor provisions of federal securities law. Actual results may differ materially from those projected in the forward-looking statements. Please see today's press release and our SEC filings for a description of some of the factors that may cause actual results to differ materially from those in the forward-looking statements. We have posted charts on our website today that we have planned 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 would like to turn the call over to Marillyn.

Marillyn Hewson

Thanks, Greg. Good morning, everyone and thank you for joining us today on our second quarter 2019 earnings call as we review our quarterly results and increased financial outlook for 2019. As today's release details, we had a very strong quarter financially, strategically and operationally. As you will see from some of the performance highlights and quarterly achievements that I will discuss in a few minutes, we have a remarkable team, dedicated and talented employees who are designing, developing and producing innovative solutions for our customers and I would like to take this opportunity to express my sincere appreciation to them.

Before I discuss the quarter in depth, I would like to take a moment to comment on the recent announcements regarding the decision by the U.S. government to suspend Turkey from the F-35 program. The U.S. government made this difficult decision and as always we will continue to follow any official guidance as it relates to the delivery of the F-35 to Turkey or the export of goods from the Turkish supply chain. Although the current program of record for total deliveries to Turkey is 100 planes, the quantities included for them in the recent lot 12 through 14 handshake agreement were a modest 8 aircraft per year. Also, Lockheed Martin has been partnering closely with the U.S. government and our supply chain to minimize the impact to the F-35 program. Over the last several months, we have been working to establish alternate sources of supply in the United States to quickly accommodate Turkey's current contributions to the program. These actions should limit any future production or sustainment impact and we remain on track to meet our commitment of delivering 131 F-35s this year. As F-35 in the fleet deliver exceptional capability and as cost continue to come down, we see increasing global demand for the F-35 that will grow the total program of record. We believe the F-35 program remains healthy and is performing exceptionally well for all of its stakeholders. We will discuss the F-35 in more detail later on the call.

Moving back to our quarterly results, the Corporation continues to perform with excellence, driving outstanding growth and strong financial results and create value for stockholders. This performance from across the Corporation and expectations for the remainder of 2019 enables us to increase our full year outlook for sales, operating profit, earnings per share and cash from operations. All four of our business areas experienced growth this quarter and each has contributed to our updated full year outlook reflecting the outstanding performance of our entire team. Our backlog has continued to increase and is again at a record level. Our broad portfolio and long-term growth opportunities have us well positioned to deliver outstanding value for our stockholders.

I will touch on a few of our financial achievements upfront and Ken will discuss our results in more detail a little later on the call. We grew sales again this quarter exceeding last year's second quarter by 8% with each business area increasing revenues from the second quarter of 2018. The growth was led by missiles and fire control from ramping production rates for tactical and strike weapons particularly precision fires as well as from increased sales in new hypersonics and classified programs. Our space organization also experienced strong sales growth with the Overhead Persistent Infrared and GPS III contracts, two programs we won last year contributing to year-over-year increases. The space, strategic and missile defense line of business also contributed to increased revenues because of strong volume in new hypersonic programs being performed in this business area.

Our segment profit increased by 6% year-over-year as strong performance across the Corporation contributed to the growth. As with sales, missiles and fire control and space led the way with improved operational performance and the growth in revenues I just discussed driving the increases. These outstanding results in sales and earnings and our focus on cost reductions and operational efficiencies also allowed us to increase our full year outlook for cash from operations to at least $7.6 billion. Our portfolio of products and services is well aligned with our customers' needs with both our legacy solutions and new technologies in high demand. Our heritage of innovation and performance remains strong and we are excited by our long-term growth opportunities.

I will discuss some significant performance milestones in just a moment, including a tremendous honor bestowed upon our F-35 team. But first, I would like to highlight a few key orders and award activities that demonstrate the value of our broad portfolio. In aeronautics, our F-35 organization and the Department of Defense announced a handshake agreement for the production of lots 12, 13 and 14 aircraft, totaling 478 jets. Once finalized, this contract will represent the largest F-35 production contract to-date and will mark the largest procurement in the history of the Defense department. I would like to express my thanks to both the Pentagon's joint program office and the Lockheed Martin F-35 team for the outstanding coordination and cooperation they have shown in arriving at this historic agreement.

Importantly, with this agreement, we now offer the Lot 13 F-35A model at a unit price below our longstanding objective of $80 million, thereby achieving this target 1 year earlier than planned. Through relentless focus on cost reductions and manufacturing efficiencies, across the F-35 enterprise, we can now offer this remarkable fifth generation fighter at a price equal to or lower than legacy fourth generation aircraft making this platform the best value fighter jet available in the world. We are proud to be able to provide this unrivalled stealth fighter to our nation's war fighters, our partners and international customers and we look forward to finalizing this agreement in the coming months.

In our space business area, our team continued to build on its previous Hacksaw and conventional prompt strike hypersonic wins. During the second quarter, we were selected as the prime contractor for the long-range hypersonic weapon system integration effort in support of the army hypersonic projects office. In addition, our space organization is part of the team led by Dynetics that was selected by the U.S. Army for the common hypersonic glide body prototype contract. We anticipate that both of these opportunities will be negotiated in the next few months and when finalized would bring the potential value of all of the hypersonic contracts across the corporation, including those awards we discussed on our last earnings call to over $3.5 billion.

Moving to Missiles and Fire Control, we received several contract awards in our tactical missile line of business, totaling over $1.6 billion which led to a quarterly book-to-bill 2.0. The three separate awards were for Hellfire

Missiles, Atacms Missiles and the recapitalization of Multiple Launch Rocket System equipment in support of the U.S. Army and international customers as demand for strike weapons continues. In Rotary and Mission Systems, our Sikorsky team was awarded $1.1 billion contract from the U.S. Navy for 12 CH-53K low rate initial production or LRIP 2 and 3 heavy lift helicopters. These aircraft are part of the Navy's 200 helicopter plan of record with deliveries beginning in early 2022. We anticipate production will continue beyond the 2030 timeframe providing long-term growth opportunities well into the future.

Sikorsky was also awarded the first LRIP contract for the VH-92A Presidential helicopter. This $540 million order follows an affirmative milestone C decision this past May and includes the first 6 aircraft of the total 23 unit plan of record. Sikorsky has been producing helicopters to transport every U.S. President and Commander-in-Chief since Dwight D. Eisenhower and we are proud to build on this heritage to deliver this remarkable product for years to come. These announcements reflect the strength of our legacy products and services as well as the demand for new solutions and platforms that are coming online. Our heritage of investment and innovation and operational performance has positioned us well to perform for our customers and drive future growth.

Moving briefly to defense budgets, it was announced yesterday that the President and the House and Senate leadership have reached a broad agreement on FY '20 National Defense Funding proposing spending levels that would be a compromise between the DoD request and the House Bills that have been approved and would represent an increase from the current FY '19 enacted values. Importantly, this agreement supports removing the restrictions placed on defense spending by the 2011 Budget Control Act caps for both FY '20 and FY '21 fiscal years. This action once passed by both chambers of Congress and signed into law would remove the prospect of automatic spending reductions known as sequestration and raise the final 2 years of budget ceilings, providing crucial near-term funding visibility for our national security objectives. We will await the details of this bipartisan action. We believe this is an encouraging step in the process to continue to provide the support for the recapitalization of our national defense assets and the investment in our country's defense.

Moving on I would like to just highlight several significant events that occurred across the Corporation during the past quarter. First, I would like to offer my sincere congratulations to our F-35 organization for being part of the automatic ground collision avoidance system, or Auto GCAS team that was awarded the 2018 Robert J. Collier Trophy in April. The Collier Trophy is presented annually to recognize the greatest achievement in aerospace in America. This award celebrated the Auto GCAS team, a collaborative group from industry and government, including the Air Force, the F-35 Joint Program Office, NASA, the Defense Safety Council and our Lockheed Martin F-35 organization for successfully completing a rapid design and implementation of life saving technologies for the worldwide F-35 fleet. This system improves the safety of aircraft in pilots using a set of complex collision avoidance and autonomous decision-making algorithms, pushing the boundaries of autonomy and artificial intelligence. This technology has already been credited for 7 F-16 sales and the F-35 enterprise accelerated the implementation of the software 7 years ahead of schedule. Lockheed Martin companies and employees, including Glenn L. Martin and Kelly Johnson have won or been part of the winning team for this prestigious honor over a dozen times since the first Collier Trophy was awarded in 1911. And I am extremely proud that our F-35 team again joins this distinguished group of innovators.

Moving to Missiles and Fire Control, our tactical and strike missile line of business achieved this key milestone this quarter on the Air-Launched Rapid Response Weapon, or ARRW hypersonic missile program. In June, our team and the U.S. Air Force successfully completed a captive carry flight test of the ARRW weapon on the service of the B-52 Stratofortress bomber mounting the missile below the aircraft's wings to gather data on drag and vibrations. The ARRW missile successfully passed the preliminary design review in March, and this captive carry test is the most recent step in the Air Force's rapid prototyping strategy to mature this hypersonic weapon.

In Rotary and Mission Systems, our Sikorsky team celebrated a key milestone with the first flight of our combat rescue helicopter, the latest rotorcraft designed to perform critical search and rescue operations for the U.S. Air Force. This aircraft based on the venerable UH-60M Black Hawk provides a significant increase in capabilities from previous rescue helicopters with extended range, more effective defensive systems, cyber security and weaponry that all lead to improved survivability. The program continues to be on schedule and this successful first flight paves the way for a Milestone C decision later this year to move the platform from the development phase into production. The program of record calls for 113 of these modernized aircrafts. And we look forward to providing this crucial rescue helicopter to help ensure the air force fulfills its mission to leave no one behind.

I will close with our space business area, whose Orion team took another remarkable step in returning astronauts to the moon with their successful demonstration of a crucial launch safety system, which completed just after the close of the quarter. Orion is part of the backbone for our nation's plan for deep space exploration and NASA's Artemis program, which aims to return humans to the lunar surface by 2024. Lockheed Martin Space, the prime contractor producing Orion spacecraft for NASA designed and built the state-of-the-art escape system to safely pull the crew module and astronauts away from a life threatening event during the launch. In this event known as the Ascent Abort Flight test, the vehicle rose to an altitude of 3,100 feet where it experienced the high stressed aerodynamic conditions expected during early flight and within milliseconds, the Abort system initiated a series of maneuvers that propelled the test version of the Orion capsule away from the rocket and into a safe descent. This test marks an important milestone as the nation celebrates the 50th anniversary of man's first lunar landing and now prepares for a return of human space flight. We are proud to continue our legacy in space exploration by supporting the Orion program and delivering the safest spacecraft ever built.

With that, I will turn the call over to Ken. Ken?

Ken Possenriede

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

Let's begin with Chart 3 in an overview of our results for the quarter. We exceeded our expectations for every financial metric in the second quarter carrying forward the strong performance from the first quarter. After generating $1.7 billion of cash from operations, we have returned over $840 million to our stockholders in the quarter. We also achieved another quarter of record backlog totaling $137 billion. And based on another strong quarter's results, we have increased our outlook for sales, segment operating profit, earnings per share and cash from operations for the year. We are very pleased with our results as we progress into the second half of 2019.

On Chart 4, we compare our sales and segment operating profit in the second quarter of this year with last year's second quarter results. Sales grew 8% compared with the same quarter last year to $14.4 billion while segment operating profit increased 6% over last year's level to $1.6 billion.

On Chart 5, we show the sales growth for second quarter by business areas compared to last year's second quarter. As shown, all the business areas experienced growth again this quarter. And as Marillyn highlighted, missiles and fire control and space experienced the highest growth in the quarter with 16% and 11% respectively. Both business areas recognized growth in their hypersonic programs. In addition, missiles and fire control sales growth also included volume on classified business and precision fires and space also saw volume increases on next-gen OPIR and GPS government satellite programs. Rotary and mission systems had 6% growth driven by multiple programs that are IWSS line of business but partially offset by Sikorsky primarily due to lower volume. Aeronautics had 4% growth driven by timing on the F-35 program, and I'll note the F-35 program is tracking ahead of the year-to-date plan. On Chart 6, we compare segment operating profit by business area in second quarter 2019, versus our results in second quarter 2018. Segment operating profit was up again this quarter compared with last year results in each business area. And here, Missiles and Fire Control had the largest increase in operating profit; 17% higher than last year, primarily driven by the volume I just discussed.

Space increased operating profit by 5% mainly due to risk retirements on AEHF and volume on government satellite programs. This increase was partially offset by lower ULA equity earnings. ARRW and RMS grew operating profit by 3% and 2% respectively. ARRW was volume driven by both F-35 production and our Skunk Works business.

In RMS at higher risk retirements and volume at IWSS, this was partially offset by a charge taken at our training and logistic solutions business.

Turning to Chart 7, we'll discuss our earnings per share in the quarter. Our EPS of $5 was 23% higher than our results last year driven by a few items. First, the quarterly volume drove higher segment operating profit. In addition, it reflects the higher FAS/CAS benefit and lower tax rate, including additional tax deductions for the foreign derived intangible income or FDII that we also experienced in the first quarter of 2019.

Turning to Chart 8, we'll discuss the cash returned to our shareholders in the quarter. Subtracting our capital expenditures from approximately $1.7 billion of cash from operations in the quarter, our free cash flow was approximately $1.4 billion. We returned nearly 60% of our free cash flow to our stockholders in the quarter between dividends and share repurchases.

And as I mentioned, we are increasing the full year cash from operations outlook from greater than or equal to $7.5 billion to greater than or equal to $7.6 billion with another quarter of strong performance. We are on track for our continued investment in the business through capital expenditures of $1.7 billion planned for the year, which as usual is proportionately higher in the second half of the year.

For the full year, we are progressing toward our cash deployment goals. Chart 9 provides our updated guidance for the year. We are increasing our sales outlook by $1.5 billion based on higher expectations for all our business areas for the rest of the year. This increase in sales was driven by strong backlog across all our businesses. Three of the four business areas had an increase in backlog again this quarter. This outlook takes us to an impressive 10% year-over-year sales growth expectation and as a reminder, our January guidance for the year was 5% sales growth. We are also increasing our segment operating profit outlook by $225 million due to the higher sales volume across all four business areas.

And comparable to sales, our segment operating profit outlook is up 9% year-over-year and as a reference point, our January guidance was above 3%. There is no change to our net FAS/CAS adjustment. We are increasing our earnings per share expectations by $0.80. I will provide more detail on this increase on the next chart. And for cash from operations, we are increasing our outlook by another $100 million to greater than or equal to $7.6 billion.

Chart 10 provides a reconciliation of our current and prior earnings per share outlook for the year. The vast majority of the increase is driven by our operational performance and volume. This results in a $0.66 increase in our EPS. The remaining $0.14 improvement in EPS is driven by a lower estimated effective tax rate from approximately 15.5% to 15% for the year. These items result in a total increase of $0.80 and a new EPS outlook of $20.85 to $21.15.

On chart 11, we show our revised sales outlook by business area. As I discussed on a prior chart, we increased our sales outlook in all of our business areas. An increase of $65 million at Space, $350 million at RMS, $300 million at Aeronautics and $200 million for missiles and Fire Control, totaling an increase of $1.5 billion above the outlook we provided on our last call.

Chart 12 provides the updated segment operating profit outlook by business area. Consistent with our sales outlook, each business segment increased their operating profit for the year. Space by $140 million, Missiles and Fire Control by $40 million, $25 million for ARRW and $20 million for RMS, totaling to an increase of $225 million above last quarter’s outlook.

And finally on Chart 13 we have our summary. We continued with another quarter in 2019 with strong operational financial performance across our portfolio. We see strength in our backlog for near-term and long-term growth prospects across all of our business areas. And based on the results of the quarter, we increased our full-year outlook for sales, segment operating profit, earnings per share and cash from operations. And with that, we’re ready for your questions. John?

Question-and-Answer Session

Operator

Thank you. [Operator Instructions] And first from the line of Peter Arment with Baird. Please go ahead.

Peter Arment

Yes. Good morning, Marillyn and Ken.

Marillyn Hewson

Good morning.

Peter Arment

So Marillyn, on the F-35 and the impact from Turkey being dropped from the program, you mentioned the production lots 12 to 14 only include roughly 8 units per year. So the questions really are – can those units to be absorbed by other partners in the program? And secondly, removing Turkey from the F-35 supply chain certainly seems more complicated, given the numerous parts that they supply. So, how quickly can those components be produced or transferred to other suppliers and do you anticipate any temporary slowdown on production? Thanks.

Marillyn Hewson

Thanks for the question, Peter. I know this is a – a lot of questions around this. But I want to just start by saying that it is a pretty fluid situation, but one in which we've been engaged with the Department of Defense for a number of months. Close to a year at looking at challenges you see on this program because there have been indications that there were discussions under way. So it's clearly a government matter. As I mentioned, we're going to always follow with the official guidance's of the US government. And so that's why we've had a lot of discussions with the Department of Defense on that. In terms of your first question about could those eight per year in the next three lots in 12, 13 and 14 by – be absorbed by others? Yes, they could. As you know, there have been additional countries that have expressed interest outside Poland, for example, they just most recently said they'd like to purchase 32 and they are in a process right now of moving through that process for their develop of request an agreement. There are other countries that have clearly indicated that they want more. We mentioned Japan in the past and others. So I don't see that as a big challenge for us to absorb them. We are – we continue to ramp up production. Related to your question on the supply chain we have been working on this for a number of months, of looking at what could potentially be the impact, making sure that we could mitigate the risk associated with the parts that are produced in Turkey. And so, we have a very good mitigation plan. Discontinuing their participation certainly would impact the supply chain posture across production sustainment to some extent. And so because of that, we've been working on it and the F-35 enterprise, the JPO, Lockheed Martin, all of our suppliers are fully confident in the strength and stability of the program and we are working – we've been working to wind down the Turkish industry involvement. And so we have a – we have a timeline that we're working toward. As you've heard, it's out through March of 2020 that we think it will all be resolved. And I think we're – and because we addressed it, it's been percolating for a while and we addressed it early, and have been working closely with the Pentagon and even they have requested reprogramming dollars out of Congress to support it. We're very much comfortable that we're on a good path to mitigate any risks to the program.

Ken Possenriede

Hey, Peter. This is Ken. The only thing I would say is we have worked very closely with the Joint Program Office, and if there is any harm to industry, we will be compensated for that. So we're working very closely with them that could – regarding cost schedule or any payment terms, we are – we will be fully compensated for that, which is obviously a good thing.

Operator

Our next question is from Carter Copeland with Melius Research. Please go ahead.

Carter Copeland

Hey, good morning, Greg and Ken, roll tide, Marillyn.

Marillyn Hewson

Good morning.

Carter Copeland

Just 30 days to go, you know, so got to get excited. One question, you talked a lot about hypersonics in your prepared remarks, obviously with the proposed M&A activity in the space that's been more topical and I think there's been a good bit of disclosure about what programs are out there in recent months. And so, I just wondered you guys have positions on several of these development prototype efforts, but when do you think we see real programs of record? How should we think about the timing and the service leadership around that, what do we think – how are you thinking about that? What's the future look like from a real sustainable program of record standpoint?

Ken Possenriede

Hey, Carter, it's Ken. And for the record, I did not go to Alabama. But since my –

Carter Copeland

That's OK. We like you, we like you all the same.

Ken Possenriede

Since my boss is sitting across the table for me, I'll say roll tide. So, you know, you're right. We have done a nice job of working with the customer set, whether it's the Army, the Air Force, the Navy, DARPA. As Marillyn mentioned, we've got $3.5 billion of contracts that are either in our backlog or will soon be in our backlog. It's – they're generating sales. They are in – all these programs are in the development, the prototype phase of their program, you'll start seeing first launch prototype launches starting next year on most of these programs, some of these programs actually have scope that is to prepare for production doesn't mean they're going to go into production. But I think once these things are either deemed successful or not in the prototype, the development phase, once we get past first launch, then I think it will be the time for that customer set to sit with us, to see if it makes sense to go into production and that's probably, say two years out would be our best guess. So you will see this year and next year and into 2021 us continue to perform on these programs from a prototype development standpoint. Perhaps shape a couple of more programs and get a few more in our backlog, but production won't happen for the next couple of years.

Operator

And next we go to George Shapiro with Shapiro Research. Please go ahead.

George Shapiro

Yes. Ken, overall can you explain, I mean you raised sales growth by $2.5 billion for the year and a lot of your business is fairly long cycle. I mean there's some shorter cycle businesses. But can you explain why it would get raised that much or is it just the prior CFO giving a pretty conservative numbers to work with? Thanks.

Ken Possenriede

So everybody is on a roll today. Thanks. Thanks, George. You know, actually if you look at our order book, and if you put aside, we assumed we would get the block buy order in the second quarter. Definitization for lot 12 and lot 13, that did not happen. If you put that aside for the year, we're beating our orders plan by $11 billion and those, some of those are pull ahead. So think of the AWE order that we got, it was for three years. So we're not getting many sales this year for that order. There are some orders this year that frankly were pull-ins or were orders that we did not expect. There were a few in F-35, we've got some follow-on modernization contracts and some sustainment contracts we did not expect. In fact Space is having the strongest year from an order book standpoint, a lot of those are in Mission Systems. There was some Orion work we did not expect, and that is why you've seen the increase in guidance for Space being as robust as it is. So roughly, that $1.5 billion, a lot of that is still in front of us in the third and the fourth quarter and a lot of that is for frankly front end orders we got this year. Also remind you that we got the OPIR contract late last year. CSC the Canadian Surface Combatant of RMS and GPS III in late last year. Those programs, especially since Space has talked about – the agency has talked about go fast, we are – we taking them by their word and we are going fast and we've accelerated sales. And so a lot of it is order book from late last year and the increase in orders we got in the first half of this year. We've done very well there. Thank you.

Operator

Our next question is from Seth Seifman with JPMorgan. Please go ahead.

Seth Seifman

Thanks very much and good morning. Marillyn, the recently announced plan to merge between Raytheon and United Technologies has brought up a lot of discussion about scale. And I think that kind of sounds to a lot of people, scale sounds like short hand for being bigger in order to absorb more development risk. And I think that's – that can be a cause of concern for investors since the industry is disciplined over the past ten or 15 years, I think it's something that investors have applauded and come to appreciate. And so, given that there seems to be more discussion on scale, do you find Lockheed having to rely more on scale as you go out in search of opportunities? And are you seeing others behave any differently?

Marillyn Hewson

Well, it's great question, Seth. I would just say that, I think for us, our scale is an advantage for us because it gives us the opportunity to invest more in research and development. I think that's true when you look across our industry, it allows us to reach out to small and medium-sized businesses and to maybe take in fact, we increased our Ventures Fund, so that we could spend more in that arena. We're looking at – we've increased our IRAD expenditure, Independent Research and Development over the last few years. So I think, just by the nature of the size of our Corporation and the financial performance of our Corporation that we've been able to invest more in research and development. An example would be, a lot of the wins that we've had in hypersonics. I mean, that's an area we've been investing in for a number of years, or directed energy autonomy, a lot of those areas is because we have been able to invest in things that we're looking at beyond today, not just on what we need to invest to keep our current portfolio relevant. I mean as we look at Raytheon and United Technology's merger, I mean we'll continue to monitor that transaction, their progresses and evaluate what that impact might be for Lockheed Martin. But I think we're very well positioned in, in terms of where we are investing, and I think just seeing our financial performance this year and increasing our outlook in terms of sales for the year and where we're taking the business, I think that just demonstrates that. So hopefully that answered your question. Anything you want to add, Ken?

Ken Possenriede

The only other thing I'd add Seth is, we do have a very robust, I will call it corporate development process, which includes everything that Marillyn talked about including divestitures and M&A. In fact, we meet with Marillyn, and the head of our corporate strategy lead on a monthly basis to review that and also to review exactly what you just described the – what impact will the scale of UTC have on us, UTC Raytheon have on us, and we're still sorting that out.

Operator

Our next question is from Rich Safran with Buckingham Research. Please go ahead.

Richard Safran

Marillyn, Ken, Greg, good morning, how are you?

Marillyn Hewson

Good morning.

Ken Possenriede

Good morning. Well. Thanks.

Richard Safran

So I was very interested in your opening remarks on the F-35 and pricing and I think it's been a while since you spoke about the F-35 margins. So I wanted to ask you a couple of things about that. First, and always to the best you can, could you discuss how much of an improvement in margins you're expecting on LRIP 12 and the new handshake deal that you're going to finalize? I realize things are still fluid there. Also in your answer, if possible, could you contrast margins on the production program with margins on the sustainment business? Thanks.

Ken Possenriede

Good bet Rich and I'll take that. So you're right. The ink is not yet dry on, on the Block Buy contract yet, but we're still going through that and we're hopeful in the third quarter, we'll have that lot 12 and 13 definitized. Regarding pricing, we have – we have, I think done a nice job with the joint program office on this contract demonstrating where we think costs are going. We've worked very closely with our supply chain in terms of driving down costs and ensuring they still got value from the program from a profitability standpoint. And you're right it is early, but the deal we think we've signed, its two parts of a profit. It's a base fee, and part of that base fee is a supplier incentive fees that we are going to receive. And that is ensuring that the quality of the work being done and also the price of the work done by our supply chain will if we hit those targets, we will be incentivized for that. The second piece is very similar to Lot 11. We're going to get a performance incentive fee and that's based on the final assembly on Lot 12 and then made on Lot 13 and 14 and we feel really good about those targets going forward and we do think if we perform, we have an opportunity to improve margins on Lot 12 through 14, relative to previous lots and part of that is the fee arrangement that we have, that incentivizes us on good performance, plus we're comfortable with the cost targets that we have for our internal costs and our supply chain. Regarding sustainment and production, we're seeing production is probably going to be higher in the future compared to sustainment. There would be one thing that could potentially impact that if we can work with the customer to get some type of PBL contract that incentivizes us to reduce cost and availability that, that potentially could help. But just based on the mix of programs on sustainment between cost plus and fixed price compared to production, which is all fixed price, we'll see higher margins on production going forward.

Operator

Next we'll go to Rajeev Lalwani with Morgan Stanley. Please go ahead.

Rajeev Lalwani

Hi, good morning, Marillyn. Good morning, Ken.

Ken Possenriede

Good morning.

Rajeev Lalwani

Marillyn, a question for you. Just coming back to some of your prepared comments around the budget and being able to get a two-year deal. Can you talk about what sort of revenue visibility that gives you and maybe how far out you can now go and then and this part might be for Ken, any implications on the capex side? I mean, having that sort of visibility at this point in time, does that put upward or downward pressure based on everything that you're seeing today?

Marillyn Hewson

So. Rajeev, I think you know, talking about budgets maybe gives us a better sense of what our customers will have in terms of where they would make their decisions, we'll have to see how it plays out in terms of what that means for Lockheed Martin. I mean, for the current budget negotiations, it appears that our programs are well supported. But again, we'll just have to wait until Congress gets through its process and closing on that. So, I can't really give you a revenue projection around that. The best thing we can do is what we're giving you in our outlook today and we're right now in our planning process that we do annually of looking what it's going to look like in the next coming years. So, we'll continue to do that. The one thing I would point to for you is the strong backlog, we have. $137 billion backlog gives you, should give you a sense of a very strong performance for us in the next few years. And then, the upside we'll see as we win more programs and build that backlog is an indication on revenue growth for us. We are very much focused on a strategy of long-term growth and continue to think that not only our portfolio of products we have today are well supported by both the U.S. and our international customers, but beyond that, we're investing in areas that we think are going to be in demand in the future. So, I feel very good about our growth prospects, but I can't really make a direct connection between what the budget negotiations are on Capitol Hill versus what our revenue growth is.

Ken Possenriede

Yes, the only thing I'd add on that and then I'll get to the capital question is, you look at the budgets that are out there and what some of the sound bites are. It does play nicely into our portfolio. So, we do feel good about that and as Marillyn mentioned, we're excited to start seeing the business areas come in and show us their long-range plan in the next quarter, and we'll give you some color on that in the October call. Regarding capex, we've mentioned, we've had we're stronger than in capital expenditures than we have been historically and we'll see that for the next couple of years and a lot of that is driven by the recent wins we had in Palmdale. So, we're building new buildings out in Palmdale for some of the classified wins that we have and I will note that, that big classified job we won last year we did get the second customer order this year, which is great news. So that's progressing as we like. We talked about Missiles and Fire Control, the ramp on production, that will continue and we're continuing to see strong demand there. So, there'll be a strong capital requirement there and at Space, we're continuing to finish up our gateway program. So, it will be around the $1.7 billion, $1.8 billion of capex probably for the next couple of years. So that's the best line of sight we have today.

Operator

Our next question is from David Strauss with Barclays. Please go ahead.

David Strauss

Thanks, good morning.

Ken Possenriede

Good morning.

David Strauss

I want to ask about the working capital build that you've seen year-to-date pretty significant, and based on the free cash flow for current operating cash flow forecast for the full year it doesn't appear like you're assuming that any of that kind of comes off through the rest of the year. Can you talk about that? And then also the potential, you know, how you're thinking about the pension contributions that you've talked about in 2021 and potentially pull that forward into 2019? Thanks.

Ken Possenriede

You bet. You're right. So, we have had some working capital growth in the first half of the year primarily in inventory and in unbilled receivables or contract assets. The thing I would say though is, we have grown the first half of the year very, very strong relative to where we were on December 31st. So, we think we're doing the working capital build in a smart way. We do see a strong cash generation in the second half of the year and then going into next year, so we do have a concerted effort to reduce our unbilled inventory, reduce the inventory that's on the balance sheet in the second half of the year and then going into next year. And we've always said that would happen to just pick, isolate and pick Sikorsky, we'll start having those development programs start going into production programs in the next couple of years. So, we will see our working capital come down in a significant way in the next couple of years. Regarding pensions, the best line of sight we have today is, so interest rates are down 75 basis points from where we thought they would be, and we've talked about our long-term asset growth of 7%. We are close to 12% year to date. I know the year is not over. So, if you look at those two variables right now, we'll go through the planning process in the next couple of months, but right now we see a pension contribution of about $500 million next year and then $2 billion in 2021 and probably another $2 billion in 2022. We will go through a financial review later this year and we'll look at the timing of those pension contributions, whether it makes sense to pull them forward and that will have to be relative to some of the debt obligations that we have in 2020 and 2021. So, we'll sort that all out in the next couple of months.

Operator

And next we have Doug Harned with Bernstein. Please go ahead.

Doug Harned

Yes, good morning.

Marillyn Hewson

Good morning.

Ken Possenriede

Good morning.

Doug Harned

You know, I wanted to go back to the F-35 and margins, because you made some real progress here with reaching the $80 million target early. If we look forward, when I think of combat aircraft programs like this, you want to be up at that kind of eventually 13% 14% type margin level. So, when you look forward, and this program matures, do you expect it to get up to those kinds of levels, and then, what kind of timeframe is reasonable?

Ken Possenriede

Yes, Doug. So, I gave you color on I gave you color on Lot 12 to 14. So, we'll hit Milestone C on F-35 soon, and we'll hopefully start converting these

FPI contracts to firm fixed price contracts. And that then will give us the opportunity to recoup more of the underruns than for the contracts we have today. So basically, today the overruns are capped just like a fixed price contract, but we are sharing in the underruns and on a few of these programs we have been fortunate where we have underrun and we've been sharing that with the United States government. So, I think it would be going forward, it would be beyond the Block Buy, and it would have to be starting when we start getting into multi-year. So, Lot 15 and beyond would be the opportunity for us to get up in to the to the 13th. And we would do our 13% we would do everything we can to make that happen, and make sure it's still a fair deal for our customers as well.

Operator

Our next question is from Joseph DeNardi with Stifel. Please go ahead.

Joseph DeNardi

Hi. Good afternoon. Ken, I think, Bruce a couple of years ago talked about kind of the three-year revenue growth goal. And I think that's obviously changed a little bit. So, can you maybe just revisit just given how strong this year has been, kind of what the framework should be for next year, revenue growth? And then what your ability is in a couple of years to offset some of these pension contributions with better working capital and that type of thing? Thank you.

Ken Possenriede

Thanks, Joe. Yes. So, I we really don't have a visibility yet into next year, and you're right we've much stronger growth, the good news is backlog is much stronger as well. So, we need to see the timing of that burn down of backlog and we won't have that visibility for another for another two months and I will, I promise give you that color on the October call. Just going forward, if you look at where we're going, from a pension standpoint, we do see line of sight out in the 2026 time period where you hopefully you recall we are freezing our pension for the most part, totally by the end of the year and we do see line of sight in '20 the end of this year, excuse me, a line of sight in the 2026, 2027 time period where we will be making a modest pension contributions generally for bargaining arrangements that we have. So, it will be out in that time period where we'll be able to do that. And just to recall, if you look at our CAS recoveries, our CAS recoveries out for the next couple of years are going to be around $2.5 billion and as I mentioned earlier, our pension contributions as we see them today in the 2021, 2022 and 2023 time period are likely to be around $2 billion, but even going farther out as our CAS recoveries go down, they will still be higher than our pension contributions in 2026, 2027 time period.

And that should be able to offset working capital to potentially fund the pension plan. So, yes, that potentially could happen.

Operator

And next we'll go to Pete Skibitski with Alembic Global Advisors. Please go ahead.

Pete Skibitski

Yeah, good morning guys.

Ken Possenriede

Good morning.

Pete Skibitski

Just thinking about the continuation of potential continuation of this great growth we've been seeing in the last few years guys at Missiles and the Fire control, I think you're still spending growth capex in Arkansas, you've got some of these hypersonic wins and I think that you've also got this, I think pretty big competitive take away in AIM-260 program. So, can you talk about the visibility that you do have that Missiles given there are some strategic priority type programs in that segment and offset by maybe some really tough comps? Just maybe talk about some of the visibility you have there. Thanks.

Ken Possenriede

You bet. So, you know, talking to Missiles and Fire Control and they talking to their customer, and I was actually being in the room with them at times. We see strong growth still across their portfolio. So, if you look at Hellfire, I mean you mentioned, Pete, you mentioned you're spot on, there is still continued capital growth there and it is bought in by the United States government, they understand what we're doing and fully support it. You will see us in Hellfire go from roughly 8,000 units, up to 11,000 units. We see line of sight of that. GMLRS from 6,000 to 10,000, ATACMS up to 500, JASSM will see significant growth, PAD will continue to see significant growth and I'm sure you saw the big order we got this year from KSA. So, we do see continued demand with THAAD. PAC-3, 350 to 500. In fact, Missiles and Fire Control has heard from their customer set that if we could build 750, they and the international customers would take them. So, we do see very,

very strong demand for the next couple of years with Missiles and Fire Control. In fact, they will likely be the fastest growing business area of the Lockheed Martin portfolio for the next couple of years.

Operator

And we'll go to Ron Epstein with Bank of America/Merrill Lynch. Please go ahead.

Ron Epstein

Hi. Good morning.

Ken Possenriede

Good morning.

Ron Epstein

I just wanted to follow up on Sikorsky. Looking at where the business is performing today, how is it performing relative to where you thought it would be when the deal was done?

Ken Possenriede

So, Ron, good morning. So, we're pleased with how Sikorsky is performing. You have a strong performance with the Black Hawk programs. We just as Marillyn mentioned in her prepared remarks, we got LRIP 2 and 3 with on CH-53K. We're happy with that performance. We're trying to shape a deal in India for the MH-60. We have a lot of international demand there. Generally speaking, we're pleased with the cost take out that we did at Sikorsky, how we integrated them into RMS. Some of the production programs have slipped to the right, understandable, I mean, normal development things that happen, but I'd say on the whole, we're very pleased with the performances of Sikorsky. We talked about the working capital growth earlier. A lot of that working capital growth is at Sikorsky and it will burn down over the next couple of years. We are trying to shape a couple of new business wins that we feel good about that, the FARA, which is the medium lift helicopter. We feel good about that going forward and then FARA which is the light lift helicopter, we feel good about that. So, on the whole, we're pleased with where things are going.

Marillyn Hewson

The only thing I would add Ron here is that we there's been a little bit of a disappointment, but it's such a small element of the portfolio. It has it's been offset by all those growth opportunities that you highlighted Ken with the commercial. We have been challenged in our commercial oil and gas area that's well known it's, it hasn't come back and I think that's true across the industry. But that's a small element of portfolio, it's has been very well offset by the growth opportunities we've seen on Sikorsky.

Ken Possenriede

And to the point I make there is, and I think we highlighted this Bruce did that, we discounted a lot of that going forward, but you're right, that would have been nice upside if the market turned.

Operator

Our next question is from Rob Spingarn with Credit Suisse. Please go ahead.

Rob Spingarn

Hi, good morning.

Ken Possenriede

Good morning.

Rob Spingarn

I wanted Ken, going back to your point on not having line of sight so much into the years, I'm just curious was this higher level of wins in the first half at any level of pull forward of awards you might have expected later this year and next year? Are these mostly market share gains, like example AIM-260 or hypersonics, etcetera, if you could just talk to that a little bit. And then Marillyn if you could speak perhaps to why you are winning some market share there, in especially in the missile side?

Ken Possenriede

You bet, Rob. You know, as I mentioned earlier, we are ahead of our we're beating, we're going to beat our plan this year by about $11 billion. You know, I'd say, Rob, it's probably half pull aheads and half things that we've shaped with our customers that were not in our plan.

So, you mentioned hypersonics, on the whole, most of those awards were not in our plan, and just to give you a little color, we're going to probably book about $600 million of sales in hypersonics this year. And then the rest of that $3.5 billion would go into the next two years as I mentioned earlier. AWE, the two additional years would be a pull ahead. The Aeronautics for the most part was, our upside, they were not pull aheads. A lot of the other space programs were upside, so Orion, additional scope is upside. The mission solution's work is new scope. We had a new order for an international customer for our SOF S-70i program. So, I'd say on the whole, about half pull aheads and half shaping by us to win new programs.

Marillyn Hewson

And then to your question about why, why do you think we're winning market share? I would just say that we have put innovation and investment in extending our products and investing in new products as the priority in this company. I mean, that's – we know that, that's where we bring value to our customers. And so it's long running investments that we have been making into the programs that are coming to fruition that allows us to win. For example, hypersonics is a great example of that, a lot of the work that we have been doing in that for a number of years. Directed Energy is another example. These are areas that – and even on our current portfolio as we look at extended ranges like PAC-3 MSE or we look at other opportunities that we can do to invest and even in our current portfolio is what allows us. And then I think the key thing is that we have got a very talented team of folks that are always focused on performance and performing on the work we have sets us up well, be able to win new business, because we can invest in affordability, we can invest in innovation to bring that value.

Greg Gardner

Okay. John, this is Greg. I think we have kind of on the top of the hour here. So I will turn it back over to Marillyn for final thoughts.

Marillyn Hewson

Thanks, Greg. So let me just conclude the call today by again reiterating that our second quarter results and our increased 2019 outlook reflect our commitment to our strategy of growth and operational excellence, because we are going to continue to deliver long-term value creation for our stockholders and innovative solutions for our customers. So once again, we thank you for joining us on the call today and we look forward to speaking to you on our next earnings call in October. John, that concludes our call today.