Good day. And welcome everyone to the Lockheed Martin First Quarter 2014 Earnings Results Conference Call. Today's call is being recorded. At this time, for opening remarks and introductions, I would like to turn the call over to Mr. Jerry Kircher, Vice President of Investor Relations. Please go ahead, sir.

Jerry Kircher

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

Statements made in today's call that are not historical facts are considered forward-looking statements and are made pursuant to the Safe Harbor provisions of Federal Securities Law. Actual results may differ.

Please see today's press release and our SEC filings for a description of some of the factors that may cause actual results to vary materially from anticipated results. We have posted charts on our website today that we plan to address during the call to supplement our comments. Please access our website at www.lockheedmartin.com and click on the Investor Relations link to view and follow the charts.

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

Marillyn Hewson

Thanks, Jerry. Good morning, everyone, and thank you for joining the call today. We are pleased to have you with us to review our first quarter results. As today's release details we had an exceptionally strong quarter, financially and operationally.

The Corporation continued to operate at a very high level and returning value to stockholders while delivering critical solutions to our customers. Our Lockheed Martin team delivered broad-based results across the Corporation and I am extraordinarily proud of their focus and efforts. I want to highlight a few key achievements in the quarter and then Bruce will follow my remarks and cover the balance of the financial metrics in more detail.

Financial results for the first quarter of 2014 were higher in almost every metric than the first quarter last year, other than a slight decline in sales. While sales decreased in the quarter, they were better than our plan and we remain on track to achieve our full year sales guidance.

Noteworthy financial accomplishments were securing new order bookings significantly above last year's level and a direct reflection of our portfolio alignment with customer requirements. This strong program alignment is essential, as customers allocate resources in today's constrained budget environment.

Beyond our solid order bookings, net earnings and earnings per share each increased over 20%, while segment operating margin matched the high point in our corporate history at 13.4%.

Through our continues focus on cash generation, we delivered over $2 billion in cash from operations in the quarter, strong and growing cash generation is a hallmark of our Corporation and a key differentiator in returning value to stockholders, while enabling continued investments in the future of our business.

I'm very pleased that strong year-to-date financial performance enabled us to increase full year 2014 guidance for segment operating profit, earnings per share and cash from operations. In addition to the increased guidance we were also able to reaffirm our full year orders and sales guidance based on bookings to-date and existing backlog composition.

This level of financial performance is a direct reflection of our world-class team as they deliver results on a daily basis to our customers and stockholders and I thank everyone for their efforts. In addition to the strong financial results, we continue to deploy our robust cash flow in the areas of share repurchases and dividend payments returning value to our stockholders.

In the quarter, we repurchased over $1 billion of our shares, more than double the amount we expended in the same period last year. These repurchases combined with our industry leading per share dividend payment returned approximately $1.6 billion in cash to stockholders.

Turning briefly to DoD budgets. In early March, the President released his formal fiscal year 2015 base defense budget at just below $500 billion. This budget is flat with FY 2014 and it's consistent with the two-year Bipartisan Budget Act caps established last December.

The President also proposed adding an additional $26 billion to the 2015 DoD base budget for opportunity, growth and security initiatives. If approved, these additional funds will be used primarily to increase budget for procurement and operations and maintenance activities.

The initial outline of base budget allocation signals solid support for our portfolio of programs. And we look forward to finalization of Congressional budget deliberations which are expected to be completed later this year.

Moving outside DoD budget, momentum continues to build in effort supporting our newly launched Lockheed Martin International organization and international expansion strategy. This past quarter, I had the opportunity to travel to multiple countries in both Europe and the Middle East to participate in wide-ranging discussions on our spectrum of products and services and the increasingly complex geopolitical environment, which requires agile and adaptive solutions for potential overseas customers.

While in the Middle East, I was able to tour our future Center for Innovation and Security Solutions in the UAE. This center will expand our collaboration with UAE government, academia and local business partners in helping bring forward new technologies.

Future technology applications are expected to be in area such as cyber security, integrated air and missile defense and other security-related areas. This center will be another link in our long-standing partnership with the people and government of the UAE.

My time in Israel enabled me to meet with the Prime Minister, participate in the opening of the new Lockheed Martin office in Be'er Sheva, expanding our Information Systems & Global Solutions presence and lastly, celebrate the arrival of the first Super Hercules C-130J to the Israeli fleet with its unmatched airlift capabilities.

We continue to see strong and expanding International interest in our air and missile defense products, air mobility, tactical aircraft, and cyber security. These areas are already showing growth in our financials as we were able to expand the international content of total corporate revenues this past quarter. We remain solidly on track towards our goal of achieving at least 20% of international sales in the next year or so.

I'd like to move to the F-35 Joint Strike Fighter and provide some color on the favorable progress the program is achieving in securing domestic and international customer support and reaching key technical milestones.

New business support of the program continues to grow, both domestically and internationally, with increased levels of annual aircraft order quantities. While the current DoD budget cap agreements for FY '14 and FY '15 resulted in some near term reductions and deferrals of planned F-35 aircraft quantities, the revised order profile still shows significant annual growth.

Fiscal year ‘14 order quantities for new aircraft are projected to increase by over 20% above prior fiscal year’s levels. And fiscal year ‘15 budget projections reflect an additional expansion of over 30% in new aircraft orders. These increases in projected annual aircraft order quantities are indicative of increasing aircraft maturity and growing customer demand for this revolutionary fifth generation fighter.

International support of the program is also expanding and helping mitigate domestic pressures from constrained budgets. Another key new business milestone achieved this past quarter was the formal announcement by the Republic of Korea to procure the F-35 for its F-X fighter acquisition program.

Their decision involved the comprehensive evaluation process of competitive aircraft and makes Korea the third foreign military sales country and 12th country overall to select the F-35. We look forward to supporting the discussions between this valued ally and the U.S. government to formalize an agreement and add a multibillion-dollar order to our backlog of future F-35 work.

Turning to the development program, while new technical accomplishments were achieved on a daily basis, this quarter included the key completion of all flight test objectives of the carrier variant aircraft using the redesigned tailhook system. Success of the newly certified arresting hook clears the way for the aircraft to conduct sea trials for the U.S. Navy in October and move the carrier variant another step closer to joining the fleet.

In the area of software, we are making good progress on the Version 2B software that will enable initial operating capability of the STOVL aircraft in 2015. And we are progressing on Version 3I software that will enable the planned IOC for the Air Force variant aircraft in 2016.

Finally, we look forward to showcasing the F-35, which head overseas in July to fly at the Royal International Air Tattoo and the Farnborough Air Show in the United Kingdom. This will mark the aircraft’s first appearance outside the U.S. and enable world audience to see some of the revolutionary capabilities of this next generation fighter.

Overall, the F-35 program is retiring development risk and increasing production tempo while reducing program costs. Shifting the focus on my remarks to portfolio shaping, we recently completed our acquisition of industrial defender, a leading provider of Cyber Security Solutions for industrial control systems to monitor, manage and protect critical infrastructures in such areas as electric power grids, chemical facilities and oil and gas pipelines.

Industrial Defender's offerings provide cyber security for automation system and operational environments in our national extension and strengthening of our existing IT cyber security business suite of solutions for domestic and international customers. This addition will enable us to offer an even more comprehensive spectrum of technology and services designed to face modern-day threats to those operational and information security.

Before turning the call over to Bruce, I want to say that we are enormously proud to receive the 2014 Catalyst Award this past quarter as recognition of our initiatives to expand opportunities for women in business. We're pleased to be the first aerospace and defense company to receive this award as recognition of the progress we've made in ensuring women's voices are contributing to the diverse perspective so essential in today's competitive landscape.

Embracing diversity is a business imperative of our corporation. It drives innovation and performance and it helps create and utilize the full potential of our team's human capital.

I'll now ask Bruce to go through the details of the first quarter financial performance and our increased 2014 guidance. And then we'll open up the line for questions.

Bruce Tanner

Thanks Marillyn. Good morning everyone. As I highlight our key financial accomplishments, please follow along with web charts that we included with our earnings release today. So let's start with Chart 3, an overview of the quarter.

Sales in the quarter were $10.7 billion, down slightly from last year but in line with our expectations for the start of this year. Segment operating margin was very strong at 13.4% and this performance along with the improvement in our FAS/CAS Pension adjustment increased earnings per share by 23% to $2.87.

We generated $2.1 billion in cash from operations, the same amount as in the first quarter of last year and returned $1.6 billion to shareholders. And we increased our outlook for operating profit, EPS and cash from operations. So we're off to a good start in 2014 extending upon our strong performance from 2013.

Turning to Chart 4 and comparing our sales and segment operating margin results for the first quarter of this year versus last year, overall sales were down 4% compared with last year. But as I just noted, this was in line with our expectations and we expect to have sequential top line growth for the remainder of 2014. Segment operating margin matched our highest level ever at 13.4% and was broad based across our business areas as we'll outline on the next chart.

Chart 5 shows the segment operating margins improve significantly over our results from a year ago. Four business areas had higher margins this quarter compared with last year with the increases for missiles and fire control and mission systems and training leading to our increased segment operating profit outlook for the year. As expected, aeronautics margin was slightly lower than last year due to a change in the program mix.

On Chart 6, we'll reconcile our earnings per share compared with the first quarter of last year. EPS in the quarter was 23% higher than a year ago driven primarily by the FAS/CAS adjustment improvement from an expense last year to income this year along with improved segment operating margin results we just discussed. Partially offsetting this increase was the lower volume this quarter and a substantial R&D tax credit in 2013 that was not repeated this year.

If you'll turn to Chart 7, we'll discuss our cash generation and deployment in the quarter. Cash generated in the quarter was very strong at $2.1 billion. This was similar to our cash generated in the first quarter of last year. The last year had nearly $350 million more in tax refunds associated with pension contributions than we had this year.

And with free cash flow of $2 billion in cash return to shareholders of just under $1.6 billion, we returned 78% of free cash flow in the quarter. Also similar to last year, we expect that cash generated in the first quarter will be the highest for the year as we have both pension contributions and tax payments planned in future quarters that did not occur in the first quarter.

On Chart 8, we'll look at our share repurchases in more detail. We repurchased 7 million shares in the quarter significantly more than what we did in the first quarter of 2013. This more than offset shares added from option exercises. The stock match on our 401(k) plans and shares issued for the vesting of restricted stock as our net share count was reduced by about 4 million shares. Since we began our repurchase program at the end of 2002, we have reduced our share count by a net of approximately 31% to our current level of just over 315 million shares.

Moving onto Chart 9. We'll discuss our updated view of the guidance for the year. We are reaffirming our guidance for both orders and sales as our first quarter results were in line with our expectations. As I mentioned earlier, sales are expected to grow sequentially throughout the year.

Our orders are heavily weighted towards the second half of the year and especially in the fourth quarter similar to what we experienced last year. We increased our segment operating profit guidance by $75 million driven by the strong performance of missiles and fire control and mission systems and training in the first quarter.

We increased our outlook for earnings per share by $0.25 and we'll describe that in more detail on the next chart. And we increased our cash from operations outlook by $100 million to greater than or equal to $4.7 billion recognizing our strong start to the year.

Chart 10 provides the reconciliation of our prior outlook for EPS compared with our new outlook. Our $75 million increase in segment operating profit results in $0.15 increase in earnings per share while our significant repurchase activity results in a lower average share count for the year that improves earnings per share by another $0.10. As a result, our EPS guidance is now $10.50 to $10.80 per share.

Moving to Chart 11. Our first quarter sales performance and nearly $80 billion in backlog enabled us to reaffirm our sales outlook for each of the business areas and in total.

On Chart 12, we show our new segment operating profit outlook by business area and in total. We increased our outlook for mission systems and training by $45 million and missiles and fire control by $30 million resulting in the overall increase of $75 million for the corporation.

And finally Chart 13 summarizes or provides a summary for the quarter. The first quarter represents another strong performance by the company with broad-based results operationally and financially. We had very good program execution and continue to take proactive measures that benefits our customers, our employees and our stockholders.

With that, we're ready for questions. Stephanie?

Question-and-Answer Session

Operator

(Operator Instruction) Our first question comes from Robert Stallard with Bank of America. Your line is open.

Robert Stallard - Bank of America

Thanks so much. Good morning.

Bruce Tanner

Good morning.

Marillyn Hewson

Good morning.

Robert Stallard - Bank of America

Bruce, I hate to kickoff with pension but I will. I was wondering if you could give us an update on what you expect to see from the CAS side over the next say two to three years and also what's your expectations for pension contributions? Thanks very much.

Bruce Tanner

Yeah. So, Rob, there is a couple of moving pieces going on with the pension discussion; I'll try to capture in my response to your question there. So CAS is going to increase fairly significantly over the next couple of years. And I would expect that our cash contributions to our pension trust will probably be at a level close to what we're experiencing this year and maybe drop off a little bit in the year what's that 2016, the year after next.

But importantly, within the discussion of pension in the near term is we do expect to see, we just had released a new mortality table that we've kind of teed up I think a few quarters back. And we would expect to incorporate that at the next re-measurement of our pension plans. And as at least as I think about the effects of that mortality table change sort of with current assumptions for the discount rate and asset returns, if those were held constant, sort of current course and speed as we usually do.

We'd expect to see both FAS expense and CAS to be higher in 2015 than it would have been without the mortality change and FAS will actually increase by a greater amount than will CAS. So that alone would result in a slight reduction of FAS/CAS income than what it otherwise would have been. But you should think of this as still being significantly greater at the end of the day in 2015 than what we experienced in 2015 on the order of magnitude of maybe 2x what we are seeing in 2014.

Cash on the other hand is likely to see some near-term benefit because we have been accelerating our pension contribution as required under ERISA. And so we are actually sitting pretty nicely even with the effects of the mortality table required cash contributions, those will come in sort of later years for us. But the CAS impact, the Cost Accounting Standards impact, will be updated prior to those required ERISA contributions, so we will actually get, as I said a bit of a near-term cash, net cash benefit. I've said a lot there, hopefully that all made sense to you there.

Operator

Our next question comes from Joe Nadol with J.P. Morgan. Your line is open.

Joe Nadol - J.P. Morgan

Thanks. Good morning.

Bruce Tanner

Good morning, Joe.

Joe Nadol - J.P. Morgan

My question is on the share repurchase plan that you guys have been offsetting for two plus years, the options issuance, et cetera. In this quarter for the first time in over two years, you broke below that 319 level. I was just wondering if you could comment on I guess the strategy with share repurchase now, are you looking at reducing the share count going forward or is this just a quarterly timing issue? Thanks.

Bruce Tanner

I will try that one as well, Joe. So good question. As I think about share repurchase, I will give you kind of a winding answer here. We've always said we are committed to offsetting share count creep by offsetting the dilutive effects, in particular by option exercises. But I'd remind you that we also, especially in the first part of the year, we also increased share count for the vesting of our restricted stock units. And all throughout the year, we make additional contributions to our 401(k) match in the form of stock as well.

So those numbers tend to creep up throughout the year and what we've said historically as well as this year is that we intend to offset that dilutive effect as I said. We also try to be opportunistic. We will do the same this year. And at least as I think, of the next three quarters or so, Joe, we've offset most of the effect of both, well, clearly of the option exercise that took place in the first quarter as well as the RSU vesting.

We will continue to offset those option exercises and the 401(k) matches as they occur over the next three quarters. There is some variability that might play into how much we buyback associate with any potential acquisitions if any, that we would make in the rest of the year.

So sort of depending on all of the things I just described, the level of option exercises, potential acquisitions if any, we could see repos at a level that would bring cash on the balance sheet about back to the level we started the year with and we started the year with about $2.6 billion. I recognize that's not what we have reflected in our current guidance but that's kind of the way I'm thinking about it right now. And maybe just one final point. I think we started the year a little under 10 million options available to be exercised.

We had about 2.3 million exercised in the first quarter, so if you sort of annualize that and that's an assumption on my part that will be spread equally there over the next few quarters. We will be at about the same level of option exercise as we were last year, 9 million plus and that would leave us literally at the end of this year with less than 1 million options left to be vested. So clearly, our rate of dilution, if you will, will start to diminish pretty significantly at the end of this year.

Operator

Our next question comes from Myles Walton with Deutsche Bank. Your line is open.

Myles Walton - Deutsche Bank

Thanks. Good morning. Actually two questions, slide one as a clarification. MST, the implied margins for the remaining nine months, can you give us some color on why the step down, obviously outsized performance here in the first quarter, but even that looks like the step down the last nine months you can help with.

And the other is the C-130 margins, I think they are pretty impressive in terms of the margin expansion in C-130. In '13, it looks like you had more margin expansion here in the first quarter. When you transition to that next multi-year, is that something we have to think about a step down with? Thanks.

Bruce Tanner

I'll give a shot at that, Myles, and see if Marillyn has any color she wants to add to it. So MST might look a little unusual for a couple of reasons. We did have a very strong first quarter of the year from an EBIT perspective and that kind of came in two flavors, one was we had some accelerated risk retirements that were actually planned for later in the year that simply because of good performance were accelerated into the first quarter, that obviously won't be a change to the year. But on the other hand, we actually had some just outright stronger performance than we had expected in the plan. And that's the amount if you will that we increased the full year outlook by for MST. The piece that might be missing a little bit in your thinking is, recall in the January call, we talked about the restructure cost and the phasing of some of the expenses.

These are expenses for a number of things, accelerated depreciation, some of the facility's movement, personnel movements and so forth, personnel relocation I should say. And we talked about that being about $80 million for the year. MST was about $25 million of that and Space Systems was at about $55 million of that and we expected to hit EBIT. I think I described that as about $0.16 hit to EPS overall had it not been for that restructure charge. And nearly all of that $25 million is going to fall in the last three quarters of the year for MST.

So, the same thing with Space by the way, well you didn't ask about Space. The vast majority, so I think probably of the $80 million, $75 million or so of that remaining restructure expense that we expect to incur in 2014 will hit the next three quarters, and just about equally spread about $25 million a quarter. So that's contributing to not just the MST scenario, but the lower going forward scenario for Space Systems as well. Now having said all that, as I look at the business areas and where we sit today versus where we expect to be at the end of the year, I do think we have some potential upside pressure, especially at MST and maybe a couple of the other business areas as well. But it's just a little too early in the quarter -- excuse me, a little too early in the year to recognize that goodness at this time.

I'm sorry, C-130. Yeah, I forgot you'd asked about C-130. So they were stronger to your point in the first quarter, Myles than they were last year. We had some step-ups associated with a couple of either completions or near completions of some contracts that to your point also are in advance of the multi-year. As usual, whenever we kind of get to the end of a contract is when you'll see the majority of those risk retirements take place. I think the multi-year as with all sort of DoD contracts, we started -- sort of started with a new sheet of paper in terms of starting with the cost at the lower level than maybe where we had on the previous contract.

So, risk retirements theoretically should be tougher from that lower number to begin with. So, I think your question is the right one and we'll just have to continue to see the sign of performance that we've had in the past. I'd like to think that we have with the international mix going forward and the international interest and not all of those FMS sale variety that we have some potential to keep the C-130 program close to where we are today. But you are absolutely right that there is some pressure going into the multi-year side of things.

Operator

Our next question comes from David Strauss with UBS. Your line is open.

David Strauss - UBS

Good morning.

Marillyn Hewson

Good morning.

Bruce Tanner

Good morning, David.

David Strauss - UBS

On F-35, it looks like most of the growth that you're anticipating over the next couple years is on the international side. And Marillyn, you did address Korea coming into the fold, but how do you feel about overall the stability on the international side? It sounds like Italy's a little wobbly, Canada is obviously reevaluating things, just how confident are you that this backlog is pretty secure? Thanks.

Marillyn Hewson

Thanks for the question, David. And I would say, we're pretty confident. I mean, we look at the next five years, close to half of our orders in the next five years will come from international customers on the F-35 program. Each one of these customers, partners, they go to their process, they periodically look at their security and their defense needs and they have to go through a decision process that, we are confident when you look at South Koreans making their formal announcement. Israel, we could potentially see additional for Israel. Australia is they moved through their procurement plan.

At some time in the future, we think Singapore will revisit the F-35 and determine when they want to buy. Canada is in their procurement process and working through that. So we feel confident that the unique capabilities of the F-35 is going to make it remain the best choice for these customers and expect it to see that go forward.

Operator

Our next question comes from Richard Safran with Buckingham Research. Your line is open.

Richard Safran - Buckingham Research

Thanks. Good morning, everybody.

Marillyn Hewson

Hi, Rich.

Richard Safran - Buckingham Research

I just wanted to ask a relatively simple question here about your outlook and your bookings guidance. So I noted that you didn't change it, I understand. But I thought maybe you could give us a bit of an update here on your booking guidance overall that you reported, when you reported 4Q. Can you tell us maybe for example, what has to happen to achieve or exceed the high end of the range and just how you're looking at it now?

Bruce Tanner

Yes. So I'll fill it out, Rich. There is a lot of moving pieces. It's a simple question, but may not be the simple answer. There is a lot of moving pieces as you would expect at this point in the year from sort of on orders or booking outlook as you described it. So I think we're actually pleased. I know the book-to-bill might have seemed a little light to some, but we're actually pleased. We actually exceeded our estimate of what we are expecting to receive from an orders perspective in the first quarter, and a lot of that frankly was international content. So we are pleased with that as well.

As I look forward in the next few quarters, I would think we should probably see a similar pattern to last year. I think if I was a betting person, I would say the next two quarters will probably receive about $10 billion plus or minus each in the next few quarters. The biggest single order in the second quarter we are expecting is closing on the Lot 8 F-35 proposal, which by itself is probably worth about $3.5 billion. There is also the FY '14 buy for the C-5 program, think of that as $600 million or so, and international PAC-3 for probably $0.5 billion -- $600 million, the FY '14 buy of the fleet ballistic missile, about $0.5 billion, and then several satellites, including our spacecraft 7 and 8 from the GPS III program and a commercial satellite that collectively is about $0.5 billion in total.

So all of that collectively again as we say, I think it's about $10 billion a quarter, both in the second and third. And then somewhere until summer, we would expect to see a pretty good sized spike in the fourth quarter. If you just sort of back into the numbers from where we are today, that's probably about -- the numbers that I just gave you, that's probably about $16 billion or so in the fourth quarter. The biggest single item there is the C-130J multi-year, that's close to $5 billion, but that's really when we get all of our sort of new government fiscal year orders. So that's not an unusual pattern that we would expect to see there. We ended the first quarter, like I said a little higher than we thought maybe at just below $80 billion and we still think we've got a chance to be above $80 billion as we get towards the end of the year.

Operator

Our next question comes from Jason Gursky from Citi. Your line is open.

Bruce Tanner

Hi, Jason.

Jason Gursky - Citi

Bruce, I've got a quick follow-up question for you and then just one quick one. On the follow-up, you talked about the impacts of the mortality tables, and there being higher FAS relative to CAS as a result of the change in the mortality table. Is there a way for you to quantify in some sort of range how much higher the FAS might be when the CAS is a result of the change of the mortality table?

Then my question is, on CapEx, you came in at a run rate of only $400 million for the year, which would be down significantly year-on-year. So I was wondering if you could talk a little bit about the trajectory of CapEx to the rest of this year, the rate they will exit the year and what that production tied to the CapEx is in the '15 and '16?

Bruce Tanner

Jason, I'll try that one. So I should have said on the -- actually the first question, we probably shouldn't refer to it as the mortality table. We actually like the term longevity table. It just somehow sounds more appealing to us than we talk about mortality. So we'll start from now on calling it a longevity table. So I did try to tee up that we'd see an increase in both FAS and CAS as soon as that is included in our remeasurement. I did not mean to imply that FAS will be higher than CAS, simply that change in FAS will be higher than the change in CAS, if that makes sense. But even with that, and that was the point I was trying to get to, Jason, even with that, saying that our pension income, if you will, will be lower than it otherwise would have been without the mortality table, we would still expect to see our FAS/CAS adjustment more than double from where we are today.

So where are we about $435 million or so today, that number is, and this again, as my usual caveat, current course and speed on the discount rate and asset return, but as we see the longevity table impact in 2015, that number is north of $800 million. So, and then beyond that, Jason, that number sort of continues to increase in the out years, at least for the next couple of years beyond 2015. So I look at CapEx in the first quarter, we're almost historically low. And I wish that were not the case frankly, but it just takes a while sometimes for us to sort of break the gears loose on the CapEx.

Last year in the first quarter, I think we did just north of $100 million, like $103 million or something this year, believe it or not, we're actually a little higher, at a $106 million. So we do expect to see, just as we did last year to kind of close on the number that we included when we give our free cash flow for the year. We do have some pretty good size items, including some restructure capital for the facilities movements that we talked last year, or January of this year including the space systems consolidation that are yet to play out, but those are bigger than maybe some of the ones we would typically have in an annual year, and that is expected to happen in the next three quarters.

Operator

Our next question comes from Doug Harned with Sanford Bernstein. Your line is open.

Doug Harned - Sanford Bernstein

Good morning.

Bruce Tanner

Good morning, Doug.

Doug Harned - Sanford Bernstein

On the F-35, we saw a reduction of quantities for the C-model in the President's budget, and there is the potential for further reductions in quantities if we see sequestration in 2016. Now, I know that your pricing for the program is volume dependent, but can you describe the impact if there is any on program margins related to the 2015 cuts, and what could happen to margins if sequestration goes into effect and we would see further cuts given the way you've structured these contracts?

Bruce Tanner

So I'll take a shot at that, Doug. So it's not inconsequential, but it's maybe not as large as you might otherwise think. So clearly, we will price the current fiscal year offering Lot 8 in this case with sort of the known quantities and run those known quantities through our overhead rates, which is where some of the variability would come in from the quantity changes so that we would capture that in sort of the instant contract that we're pricing. Where we may have a bit of pressure is prior contracts, so Lot 6 and 7, for instance, would have been priced with an assumed higher quantity of F-35s going forward in Lot 8 and beyond. So sort of the overhead absorption impact of losing those quantities of aircraft will play out and hit, if you will, some of the performance of Lot 6 and 7. Obviously, we will try to mitigate as much of that as possible, but unfortunately not all of our overhead is 100% variable. So, some portion of the fixed cost will get spread in any event.

So -- and the other side of that is not so much on 6 and 7, but some of the prior aircraft and some of the other businesses with our contracts within Aeronautics are flexibly priced, cost plus in nature or fixed price incentive in nature. So there will be some sharing of those cost increases result of that base deterioration. I should remind you that all this has yet to play out completely because for instance the program of record, which is what we've tied to on the F-35 program. So while it would have had higher domestic quantities of aircraft than what we’re pricing the previous few lots on, that program of record for instance did not include the South Korean aircraft quantities in it. So there is at least hopefully somewhat of a mitigating aspect of that in the not too distant future.

Operator

Our next question comes from Noah Poponak with Goldman Sachs. Your line is open.

Noah Poponak - Goldman Sachs

Hi, good morning, everyone.

Bruce Tanner

Good morning, Noah.

Noah Poponak - Goldman Sachs

Bruce, going back to the margin conversation, I guess the company has realigned businesses is making changes with facilities, making changes with other costs that where the numbers are pretty large, but I guess we don't know what the starting point was. So I'm sort of curious if there is a way to categorize how much more can still change from a cost perspective to boost margins? And then forgetting about this year, forgetting about next year, just bigger picture, longer-term, is this low 13% segment operating margin in the realistic scenario analysis of what the long-term Lockheed Martin segment operating margin can be?

Bruce Tanner

Let me think about that for a second, Noah. You asked a lot of detail there. I have got to get my head around it, but how much sort of my summation and how much more cost takeout potential is left. I always believe and Marillyn has engrained this in my thinking and probably the corporation's thinking, but we try to get to as much of -- as I have said this in the past, there is much of a variable cost mentality as possible. And so a lot of that is sort of environmentally dependent and not all of our business areas are sort of created equal in that regard.

So one of the more flexible businesses we have for instance is our short cycle IS and GS business, where we have a lot of facilities that are leased in nature and not owned, not all of them by the way but a lot of them are. So we've been able to flex pretty dramatically, if you just flip back to last few years at IS and GS and look at the unfortunate headcount reductions we've had to take, we've been able to maintain margins throughout that period with a pretty sizable reduction in our overall workforce.

So that’s for instance one business area that has the ability to flex to match this environment. Some of our longer cycle businesses as you would expect like Space Systems, our Aeronautics they have higher capital cost content and therefore that’s harder to remove, but one of the things we've been trying to do is take a look at our total square footage and optimizing our square footage around the corporation. So the moves that we just announced in November were to take out another 2.5 million square feet on top of about 2 million square feet we’ve done in the past few years. So, well over 4 million in total. That’s just sort of sizing the operations to the environment in which we operate. I think we’re good at that. I think we are good at that across the corporation.

So you never know what you have to do until you sort of hit with the predicament that the environment throws at you, but we work it very hard. I will also remind you that probably two-thirds of our cost is in the supply base, so we try to get that as well under control. That’s the big part of it as well. And while we are reducing space in some areas, we are actually growing concurrently in other areas. So for instance our Troy, Alabama facility or Camden, Arkansas where we are doing some of the THAAD production and some of the missile production, missile and fire control is actually growing.

So we've got this constant increasing and decreasing. I think we've become very good at that over the years. So I don’t think that we've reached a limit as far as what we can or cannot do in the future. Then as far as the 13% long term, given that we've hit that twice and that’s the highest I would say, that's a hard hurdle for us to maintain and especially in the near term as we talked about in the past with the significant growth coming on the F-35 program at lower than the overall margin rate, that's clearly going to put pressure on our ability to achieve that. The flipside of that argument though is our international content is expected to grow over the near term. I think we'll hit close to 20% this year and we could do more than that in the next couple of years even. So that typically would have a mitigating function, but overall I'd say it's going to be hard to maintain the 13%, that's just a level we've achieved infrequently and it'll be hard to maintain that going forward.

Operator

Our next question comes from John Godyn with Morgan Stanley. Your line is open.

John Godyn - Morgan Stanley

Hey, thanks for taking my question. Bruce there is a lot of debate among investors on how to really think about these pension tailwinds and what they mean for the stock. I was hoping to focus in a little bit on the cash part of it. The cash tailwind from prepayments for CAS harmonization and better understand how the management team thinks about it for capital allocation of future. I guess at the extreme, some would argue that a temporary tailwind should be returned to investors in I guess above normal buybacks or something of that nature.

That might be too simple but it also seems like too simple that a tailwind that's not going to last forever has no impact on how you think about capital allocation going forward. So I am just curious if you could kind of focus then in on that and maybe help investors understand how they should treat it for the purposes of allies in the stock? Thanks.

Bruce Tanner

Well John, I appreciate the question. I think it's a very well thought out question. So let me try to address everything you described there. So in years past and not this year we've tended to whenever give the EPS performance we've given adjusted EPS try to take into account the fact that we thought our GAAP reported earnings were probably understated relative to the valuation of the company.

And that wasn't necessarily good measure for our investors to be basing their valuation of the stock upon. And so now we've got the flip situation that were our reported earnings are actually getting a tailwind as you said because of the FAS/CAS adjustment. So what I have been trying to preach for a number of years is that the real valuation upon which the stock should be valued is the cash flow and sort of the cash flow per share to be specific with that.

So at least as we look at even with the substantial conversion from expense to income this year, as I said, I think $430-ish million or so of income added to our segment operating profit that takes us to the current outlook again of about $10.55 to $10.80. I think our free cash flow per share this year is somewhere north of $11.30.

And so when I think of cash deployment in particular and I look at the payout ratios from a dividend perspective or in the cash available for share purchases, I'm very much focused on our sort of free cash flow per share. And I think that number grows over the next couple of years, potentially pretty significantly as we start to finally recover some of this $9 billion or so that we've had pre-funded into our pension trust that we've yet to recover via our billings to the government.

Now the mortality table that I've just described has some longer term implications that I've described. Obviously as people live longer that will require additional contributions over the longer term that should get reimbursed on our CAS contracts. But as I said earlier and I forgot who asked the question, in the near term, that actually is an upper to cash flow because we don't expect to have near term much of an incremental increase in our required contributions but our CAS to our government customers will reflect that mortality table change earlier.

So this is -- that's the way I think of it. Very much looking at it from sort of a free cash per share basis and on that basis I think we still got some upside from both the dividend potential as well as share repurchase potential going forward.

Operator

Our next question comes from Ron Epstein with Bank of America Merrill Lynch. Your line is open.

Ron Epstein - Bank of America Merrill Lynch

Good morning, Bruce and Marillyn.

Marillyn Hewson

Hi Ron.

Bruce Tanner

Good morning Ron.

Ron Epstein - Bank of America Merrill Lynch

Just want to ask maybe a question on -- a broad question on capital allocation. So when you think about Lockheed's stock at current levels and buying it here. Do you think there's other places that the corporation can invest for growth? Right, arguably buying back the shares helps the earnings per share, but it's not really a strategy to fuel growth for the future, right. I mean, are there other things to do and really contemplating it. Can you talk about that?

Bruce Tanner

I'm going to give a shot and I think Marillyn -- may actually probably here as well. But so we're not -- this is not an idle conversation that we have. We don't automatically drop to the fact that we need to be buying back shares and that's the best use of capital. We actually do look at growth opportunities for the corporation. We did two small acquisitions in the first quarter as we described.

We did those because we do believe that there is growth potential in both of those acquisitions. And so the other thing we try and do is invest internally. So as you think of some of our independent research and development, if you take a look over the last two years, we're up some $100 million or so and just the level of IRAD.

So we're trying to do what's right from a -- supporting our shareholders as well as supporting internal growth. I mentioned we just invested in a terrific facility in Palo Alto in California to create a new lab for our -- one of our organization out of Space Systems that's sort of forward-looking piece of that business.

So I think we're making those right decisions, but honestly as we look at the environment right now there's not enough of those to justify the ample cash that we are throwing off right now as a very mature business and in an environment that we're in from an overall budget perspective. And probably the last thing you would want us to do is to go chasing growth and overpaying for growth. So given those prospects, I think what we're doing is is what most investors would hope us -- for us to do and we're doing that in a very thoughtful and hopefully prudent manner.

Marillyn Hewson

I'd just add to that as well, Ron, that if you look at the things that we are investing, and as Bruce said we were up on our R&D expenditures last year. Over the past five years, we've invested more than $3 billion in the research and development, things like advanced materials, advanced manufacturing, we're doing things in autonomy and robotics, so the acquisitions remain in the unmanned space, quantum computing, cyber, energy.

There is a lot of areas that we're continuing to invest in. And importantly, we're also continuing to invest in our current portfolio to keep it relevant. So making sure we're listening to our customers, extending the range, for example, on the PAC-3 and THAAD and JASSM and some of the key capability, LRASM are opportunities that we look at it offering different variants of the LCS to the international marketplace.

We are definitely continuing to maintain that portfolio and look for opportunities, advanced concepts and things that we can do to stay ahead of what our customers' needs are. You saw probably the SR-72 that we rolled out, which was a capability we've been working on for a number of years and we've got a ways to go yet and demonstrate it.

But having an intelligent surveillance reconnaissance capability with the potential for strike platform, which is very interesting. That's just one example, but one that I think makes the point if we're going to continue to do what we do as a corporation to be focused on being a technology leader because that is the value that we create for our customers.

Operator

Our next question comes from Carter Copeland with Barclays. Your line is open.

Carter Copeland - Barclays

Hey good morning. Almost afternoon.

Marillyn Hewson

Good morning.

Bruce Tanner

Hi Carter.

Carter Copeland - Barclays

Bruce just one clarification and then a question if I will on the longevity table as you stated. The dynamic for 2016 and '17, if you look out beyond '15, presumably it's the same sort of impact in terms of FAS being revised up more than CAS on a relative basis in those years similar to what you're seeing in '15. Is that correct?

Bruce Tanner

Yeah, it is Carter, but I'll make the -- hopefully the same point that I tried to make on the 2015. Even after that adjustment, we would still expect to see increasing pension income even after the longevity table is implemented from '15 to '16 to '17.

Carter Copeland - Barclays

You're still expecting a pretty sizable step out to the contribution out there and I guess, its '16 or '17.

Bruce Tanner

So we've got a fairly large contribution required in '17 that we've also got a fairly large CAS recovery as we kind of get to the end of the CAS harmonization timeline there. So I would expect -- I'll say net-net cash from our pension to actually increase over those same years that you just described.

Carter Copeland - Barclays

Okay. And then with respect to the DoD or the domestic versus the non-DoD or international growth. And with respect to the 4% decline this quarter, how would that have looked on a domestic versus international basis? And if you could do the same for bookings, that would be helpful as well?

Bruce Tanner

Yeah, so I think -- and I'm doing this with little at top of my head Carter, but at the discussion we had with the media earlier today, I made the point that if you just take a look at our DoD sales on a standalone basis, they dropped 4% from the year 2012 to the year 2013. And then we expect pure DoD sales to drop another 6% from the end of 2013 to the end of 2014.

So a 10% drop year-over-year from '12 to '14. What's lost in some of that discussion though was we actually expected 2014 before sequestration to actually have an increase in sales amount. So arguably from a planned perspective, we're actually down more than the 6% that I talked about just now because that's sort of going actuals to the end of the year expected actuals and not recognizing what it otherwise could have been without sequestration.

Hopefully, that made some sense to you. In the quarter itself, so in the non-DoD or the international content specifically, we're looking at something like a 13% increase year-over-year in our total international sales, and that's --

and as a guess, from a total perspective we're going from roughly 17% to right at or just a little bit below 20%. So but for the international growth, we would have seen a much larger impact because the DoD is again decreasing about 4% cliff. So the reason we're sort of down only the 1% or so that we're guiding towards is because of the mitigating effects of the international sales.

Jerry Kircher

Stephanie, this is Jerry, I think we're coming up on the hour, so maybe we'll just turn this over to Marillyn for closing comments.

Marillyn Hewson

Thanks Jerry. As we conclude today, I want to restate that the Corporation had another outstanding quarter and is well positioned to deliver even higher value to stockholders and customers as we progress through 2014. Our robust cash generation, strong backlog of domestic and international work, a solid balance sheet and the exceptional execution of our employees will continue to propel our corporation forward in 2014 and beyond.

I'm confident in our future and because of the outstanding innovation, performance and integrity of our workforce. We will continue to support our customers in their essential missions. Thanks again for joining us on the call today. We look forward to speaking with you on our next earnings call in July. Stephanie, that concludes our call today.