Good day. And welcome, everyone, to the Lockheed Martin Fourth Quarter and Full Year 2016 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. Greg Gardner, Vice President of Investor Relations. Please go ahead, sir.

Greg Gardner

Thank you, Stephanie, and good morning. I'd like to welcome everyone to our fourth quarter 2016 earnings conference call. Please join me today on the call -- joining me today on the call are Marillyn Hewson, our Chairman, President and Chief Executive Officer; and Bruce Tanner, our Executive Vice President and Chief Financial Officer.

Statements made in today's call that are not historical fact are considered forward-looking statements and are made pursuant to the Safe Harbor provisions of federal securities law. Actual results may differ. Please see today's news release, our SEC filings and chart two on the webcharts for a description of some of the factors that may cause actual results to vary materially from anticipated results.

As noted, we have posted charts on our website today that are -- 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, Greg. Good morning, everyone. And thank you for joining us on the call today. All of here, hope your New Year is off to a good start. Let me begin by saying that I am extraordinarily proud of our Lockheed Martin team. Their dedication and focus enabled us to achieve outstanding program and financial performance during a dynamic year of transition and I want to thank them for their efforts.

Our performance as a corporation allowed us to exceed all of our full year goals and has positioned us for future growth and to continue to deliver value to customers and stockholders in 2017. While Bruce will cover the financial results in detail a little later, I want to highlight a few noteworthy 2016 financial accomplishments from my perspective.

2016 was an exceptional year of achievement, with all of our financial metrics exceeding our expectations and in the case of sales, earnings per share and cash from operations exceeding our previous historical high watermarks.

I was especially pleased with our performance in maintaining our focus on new business wins and building backlog. We received almost $19 billion in order bookings in the fourth quarter, which resulted in our achieving a quarterly book-to-bill ratio of 1.4 and a year-end backlog of over $96 billion. This represents over $1 billion increase from 2015 year-end level and reflects the broad demand for our products from both domestic and international customers.

Significant awards included $7.2 billion for our F-35 LRIP 10 and definitized contract action agreement, a $1.5 billion award for PAC-3 missiles defense capabilities for United States and allied military forces and $1.2 billion from the Republic of Korea Air Force to upgrade 134 of their F-16 aircraft. Our strong and growing backlog has positioned us [Technical Difficulty]. Sorry for the interruption there [inaudible] (03:57). Our strong and growing backlog has positioned us to deliver expanding sales level and outstanding financial results as we move forward.

Another area where we are, it sounds like somebody is not on mute. Let me just continue. Another area where we were successful with our strategic focus on cash and cash deployment, in 2016 we generated nearly $5.2 billion in cash from operations, reflecting the commitment focus of our team in executing on contracts for our customers on a daily basis and we expect to exceed our initial three-year $15 billion commitment we originally laid out in October of 2014 by $1 billion. This strong cash generation also enabled us to continue our longstanding cash deployment strategy.

In 2016, we returned 100% of our free cash flow to stockholders through our competitive dividend and ongoing share repurchase activity. Keeping with cash deployment our 2016 share repurchases exceeded $2 billion and coupled with the shares retired earlier in the year as part of our divestiture of the IS&GS business allowed us to reduce our year-end outstanding share count to below our target one full year ahead of our stated goal. These achievements reflect our ongoing commitment to perform with excellence for our customers and stockholders.

Looking beyond 2016, our 2017 guidance outlined today shows that we are expecting solid organic growth and continued strong cash generation, and Bruce, will provide a detailed review of the guidance and assumptions in his comments and webcharts.

I'd like to turn now to the status of DOD budget. Currently, the DOD is operating under a continuing resolution through April 28th for fiscal year 2017 with funding constrained to prior FY16 levels. While this will cause funds to be limited for certain DOD programs and likely delay expansion in others, we do not believe our 2017 sales, earnings or cash flows will be affected by this delay in receiving the full appropriations bill. We forecast that prior year's appropriation levels will support our current plans as our broad portfolio of long cycle programs remains well-aligned with our customers' needs.

Further support for this conclusion is that the continuing resolution also allows for a limited set of exceptions, which include the ability to additionally fund two of our programs, advanced procurement for new multiyear Black Hawk helicopter contract and sufficient funding to maintain the Orion Multi-Purpose Crew Vehicle program launch capability and schedule. While we believe the possibility of a full-year CR still exist and would not be in the nation's best interest, we are hopeful that a resolution can be reached to maintain our country's readiness and strength.

Separately, the 2017 National Defense Authorization Act was signed into law last month and reflected bipartisan agreement that defense budgets should not return to amounts defined by the Budget Control Act or sequestration levels. I am personally encouraged by that fact, but there is recognition from both parties that global security threats are not decreasing and that in fact we do need to continue to put resources toward our national security and our interoperability with our allies around the world.

We look forward to the upcoming submission of the new administration's budget proposal and continued congressional support for a strong defense and future recapitalization actions both in FY 2017 and beyond. We look forward to working with the new Pentagon team as we collectively look to provide our armed forces with the capabilities needed to perform their crucial missions.

I would like to continue my remarks with a few highlights from the fourth quarter that illustrate the continued upward momentum we have in our operational performance as we delivered daily on the commitments to our customers.

Starting with the F-35 Joint Strike Fighter, we delivered 16 aircraft in the fourth quarter, including the first planes for customers beyond our original eight partnered nations, Japan and Israel. These countries represent our ninth and 10th international customers, and along with South Korea show building international interest and the capabilities of this remarkable plane.

In November, Luke Air Force Base welcome the arrival of its first Foreign Military Sales or FMS aircraft as Japan took ownership of its first F-35, where it will be used to train an elite cadre of Japanese air self-defense pilots and maintainers.

In December I traveled to Israel to attend the delivery ceremony for the first pair of Adir F-35 stealth fighters for the Israeli Air Force. The IAF has embraced the technologies and capabilities of this fifth-generation fighter and believe it will become a powerful accelerator for their entire air force.

Also during the fourth quarter our F-35 backlog grew as we received an undefinitized contract for LRIP 10, which added 90 planes to our flow. This brings our total F-35 orders to-date up to 373 planes. Just as significantly, our 2016 deliveries of 46 jets brought our total deliveries to 200 aircraft at the end of 2016. We expect 2017 to be another inflection point in our production cycle as we now anticipate delivering 66 planes, an increase of over 40% from our 2016 level.

As many of you know, I have the opportunity to meet with President Trump on two occasions prior to his inauguration to discuss our F-35 Joint Strike Fighter program. We along with our partners share his strong interest in producing this unparalleled aircraft at affordable prices for our warfighters and taxpayers. We believe we are on this path and I'd like to take a moment to give you a quick status of the program.

At this time, I'll ask you to turn to the third page in the webcharts that we have provided. This chart depicts the F-35A model per unit price, which is the Conventional Takeoff and Landing or CTOL variant. The chart also depicts the F-35 program order quantities. The bar graph portion of the chart shows our historical and projected orders.

You will also observe a dark descending line on the graph, which shows the per unit price of our CTOL variant in each LRIP as notated by the axis on the right. You can see from our latest status on our LRIP 9, our current F-35A is now around $100 million apiece and drops below $100 million for LRIP 10.

The LRIP 10 price is currently proposed with represented reduction of over 60% from the first LRIP 1 aircraft and this demonstrates a learning curve as efficient as any achieved on any modern tactical fighter aircraft.

The chart also includes a red dotted line, which represents the government program offices annual budget estimate to Congress of the F-35A unit price. This selected acquisition report or SAR is submitted annually to Congress as part of the yearly budgeting process in advance of our contract negotiations for each lot.

As you can see we have had eight consecutive years of achieving settlement unit prices below the internal government expectations, showing our ongoing commitment to producing this aircraft with increasing affordability.

You will also see the rapid ascent and quantities on the chart. It is with this anticipated trajectory and production that we can continue to see the efficiencies in touch labor, manufacturing techniques and supply chain operations that we project will allow us to meet our stated goal of offering the CTOL version for $85 million by 2019. We believe this will result in the best combination of capability and price of any aircraft ever offered, while at the same time growing valuable job opportunities for our American workforce.

Turning to our Space Systems business area, I'd like to highlight another example of one of our innovative products and the benefits that can be derived from our long-term commitment to technology, our customers and their missions.

In November, we successfully delivered the Lockheed Martin built GOES-R satellite to Cape Canaveral Air Force Station in Florida. The spacecraft was launched on a United Launch Alliance Atlas V rocket and placed into geostationary orbit 22,000 miles above the earth as the first of four in a next-generation weather satellite constellation.

We are excited to be leading the GOES-R program, a collaborative mission between NASA and NOVA, which will provide major improvements to quality, quantity and timeliness of critical weather data. This constellation will improve the detection and observations of meteorological events that directly affect public safety, protection of property and ultimately economic health.

I'm especially pleased that the company's Advanced Technology Center in Palo Alto, California contributed key instrumentation that will fly aboard each spacecraft, including the Geostationary Lightning Mapper or GLM.

The GLM will take hundreds of images every second, mapping lightning activity on the earth surface and in the atmosphere. Scientists are hoping to use data from the GLM and GOES-R satellites to provide citizens and public safety officials early warning of severe storms and tornado activity.

Finally, I'd like to take a moment to congratulate our Sikorsky team for delivering the 1,000th H-60M Black Hawk helicopter this past quarter at a ceremony in our Connecticut facility. This version of the Black Hawk dating back to 2007 has been consistently enhanced with more powerful engine, improved airframe and modern avionics, and it is a key element of the Army Aviation Modernization Plan.

The Black Hawk has been noted as the workhorse of army aviation and including the entire Black Hawk family, Sikorsky has delivered over 4,000 Black Hawk helicopters, which have blown over 9 million flight hours. We are honored to be part of this heritage and look forward to continuing this proud legacy.

In closing as I reflect back on our accomplishments over the past year, we completed our strategic actions to better align the business for operational and financial success, and long-term value creation. We increase sales, grew our backlog and had strong cash generation, while continuing to perform with excellence for our customer. Looking to the future, I am enthusiastic about our corporation’s broad portfolio and the growth opportunities that it provides both domestically and internationally.

I'll now turn the call over to Bruce to review our financial performance in more detail, outline our 2017 financial guidance and then we'll open up the line for your questions.

Bruce Tanner

Thanks, Marillyn. Good morning, everyone. As I highlight our key financial accomplishments, please follow along with the webchart we included with our earnings release today. My remarks begin on chart four and an overview of our financial results for the year.

Before discussing our 2016 financial results, I want to provide an understanding of the material weakness and internal controls that we described in our earnings release. This materially weakness relates to a number of deficiencies in internal control over financial reporting that is limited to Sikorsky only.

While we have not discovered any material errors in the financial results included in our earnings release today, our reviews of the internal control processes and IT-related controls over financial reporting at Sikorsky indicated a reasonable possibility that a material misstatement could have occurred that would not have been prevented or detected on a timely basis, which is enough to determine that a material weakness in those internal controls exists.

That finding in turn triggered a more thorough review of Sikorsky's financial statements to determine whether or not that potential for misstatement led to an actual material misstatement in our consolidated financial statements and at this time we have not found that to be the case.

We expect to have completed our analysis of Sikorsky's financial statements when we file our Form 10-K in February. Thereafter, the remediation process will continue as we’ll have to correct and then test the remediated controls over several reporting cycles. We will provide updates on our progress as we file our Form 10-Qs in 2017 and we expect that the remediation will be completed prior to the end of fiscal year 2017.

Moving on now to our 2016 results. Overall, we finish the year a little stronger than the outlook we provided to you in the October call. We obtained the highest sales, earnings per share and cash from operations that we've ever achieved, we continued our track record of returning substantial cash to our stockholders and we grew backlog to more than $96 billion, significantly strong sales volume in the year. So, overall, we are very pleased with our results for 2016 and we think this positions us well as we enter 2017.

I’ll add this, also nice for me and perhaps for you as well, to have the many portfolio shaping activities that occurred during the year behind us, hopefully making it easier to both explain and follow the results of the company going forward.

Turning to chart five, we compare our sales and earnings per share in 2016 versus 2015. Sales were nearly $7 billion higher this year compared with last year and most of that growth came from having a full year of Sikorsky performance and results of RMS for 2016 versus less than two months in 2015 and significant organic growth in Aeronautics driven by the F-35 program.

Earnings per share grew by 25% over last year's level, driven by higher segment operating profit and FAS/CAS adjustment, the benefit from a lower tax rate and a lower share count due to share repurchases in the year and the results of the share reduction associated with the IS&GS divestiture.

Within the 2016 results we also had the benefit of recognizing the booking resulting from obtaining a controlling interest in the U.K.'s Atomic Weapons Establishment that we discussed on the last call. That gain increased EPS by $0.34 for the year.

Chart six shows our actual cash from operations generated in 2016 and outlook for 2017. During the October call, we discussed that our cash projection in 2016 has significant variability in it driven by about 700 million in F-35 collections that could have been received in either 2016 or 2017 and we sized our 2016 cash from operations at $5 billion or $5.7 billion. We also said that if the $700 million was not received in 2016 it would simply be added to our outlook for 2017 resulting in a two-year outlook for cash from operations of greater than or equal to $10.7 billion.

As it turns out we did not received a $700 million in collections in 2016, but we did generate $5.2 billion in cash from operations even without those collections and we are keeping our 2017 outlook at the $5.7 billion level resulting in a two-year outlook of greater than or equal to $10.9 billion or $200 million more than we said in October.

If you will turn to chart seven we'll discuss the amount of cash we returned to stockholders in 2016. With our cash from operations of around $5.2 billion and capital expenditures of almost $1.1 billion, our free cash flow in 2016 was a little more than $4.1 billion and with $2.1 billion of share repurchases and $2 million of dividends paid, we returned a 100% of our free cash flow to stockholders last year.

On chart eight you can see how our consistent focus on returning cash to our stockholders have resulted in a significant reduction in number of shares outstanding. We reduced our shares outstanding by 36% from our peak share count level of 456 million shares in 2002 and we achieved our goal of reducing outstanding shares to below 291 million shares one year earlier than our target date. As a reminder, we anticipate $2 million of share repurchases in 2017.

Chart nine provides our 2017 outlook, our sales guidance is between $49.4 billion and $50.6 billion and our segment operating profit range is between $5.015 billion and $5.135 billion. Our FAS/CAS adjustment is $880 million for 2017 and we will discuss this in more detail on the next chart. Our earnings per share are expected to be between $12.25 and $12.55 and our cash from operations is expected to be equal to or greater than $5.7 billion as we discussed earlier and this represents a good start to achieving the goal we established in October of generating $15 billion or more of cash from operations during 2017 to 2019.

On chart 10 we compare the FAS/CAS adjustment outlook that we provided in October with what we are providing now. In October, we expected an adjustment of $800 million since then interest rates increased probably our discount rates to increase to the 4.125% level by year-end, 50 basis points higher than we projected in October.

The increase in discount rate increased our FAS/CAS adjustment for 2017 by $240 million and we lowered our outlook for the long-term return on our pension assets from 8% to 7.5%, recognizing the downward pressure on the equity and fixed income asset classes in our trust, lowering the long-term return on assets lowers our FAS/CAS adjustment in 2017 by $160 million, partially offsetting the increase resulting from the higher discount rate and netting to a FAS/CAS adjustment of $880 million for 2017.

Chart 11 provides our sales and segment operating profit outlook ranges by the four business areas. I recall a briefing we gave in New York City at the end of 2006 where we said that the Aeronautics business area would grow from its $11 billion revenue level then to more than $20 billion by 2015. Given all that's happened since that time reaching $20 billion in 2017 still feels like a nice accomplishment for our Aeronautics team and has enabled us to forecast 2017 revenue of $50 billion at the midpoint of our guidance.

And finally, we have our summary on chart 12. We achieved exceptional performance in 2016. We continued our cash deployment practices and generated strong returns for our stockholders, and we completed our portfolio shaping actions, which we believe positions us for the continued long-term value creation.

With that, we are ready for your questions. Stephanie?

Question-and-Answer Session

Operator

Thank you. [Operator Instructions] Our first question comes from Cai von Rumohr with Cowen & Company. Your line is open.

Cai von Rumohr

Could you basically update us in terms of where you are in your negotiations on LRIP 10 and whether you intend to basically take any legal action in terms of the way the [inaudible] (27:07) of LRIP 9 was determined?

Marillyn Hewson

Thanks for the question Cai. I will take that on and Bruce do you have anything to add you're certainly welcome. On LRIP 10 we are very close to a deal as some of may have seen in the media I expressed that after my discussions with President Trump recently. We are very close to a deal that would allow us to close LRIP 10 in the near-term and so I expect that will be very soon. On LRIP 9, basically we are not under any pressure to do anything further on LRIP 9 at this point. We are just going to continue to look at our options on LRIP 9. Anything do you want to add Bruce?

Bruce Tanner

No, no. I think that capture it, Marillyn.

Marillyn Hewson

Thank you.

Operator

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

Ron Epstein

Yeah. Hey. Hey, good morning, guys.

Bruce Tanner

Hi.

Ron Epstein

When we perhaps think about modeling the program, the F-35 program as we go out over the next several years, I mean, one question I get a lot from investors is, I mean, how should we think about the margin profile? I guess what I am asking is one of the fears is on Lot 10 pricing, I mean, are we going to see a margin step-down or I mean, can you give us a broad way to think about the margin progression of that program?

Bruce Tanner

Hey, Ron, I will take a shot at that. So the way I think of it, Ron, we have given, I think, a very consistent speech for a number of years about our expectation that the F-35 program will have sort of sequential year-over-year margin improvement up to the point that probably we reach full rate production at which point it ought to look a lot like other production programs at that sort of thing stage of their lifecycle.

And at least as I look with the expectation of where I think the agreement on LRIP 10 is going to come out. I don't think we would deviate from that discussion at this point in time, just to put in some perspective, I think, if F-35 from 2016 to 2017 the margins that we are expecting in between those two years is probably growing 90 basis points not quite 100 basis points year-over-year. I think that’s going to happen with the results that we expect to obtain on the LRIP 10 negotiation. And thereafter, I would expect that we would continue to have some margin improvement maybe not as at higher rate as we experienced from sub 2016 to 2017, but still have sequential increase in margin after the full rate production programs as we have talked about in the past.

Operator

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

Rich Safran

Marillyn, Bruce, Greg, good morning. I have a question on Brexit and international, so one fallout, potential fallout from Brexit is the impact on the U.K. defense spending. I was wondering if you have had any discussions with the British Government on this topic, if you expect much of an impact. And on the topic of international, can you give us an update on the discussions you are having with international customers, for example, how they are viewing the change in administration, are you expecting a continued step-up in international demand, is there any change in emphasis on direct versus FMS, that sort of thing?

Marillyn Hewson

Thanks for your question Rich. I will just start with Brexit question and in terms of U.K. defense spending, I haven't had any impact and input from the U.K. MOD that they're going to move off of their strategic defense plan, they have a strategy and their normal review that they will continue to spend on their defense spending. So we haven't seen any impact from that. No indication that that's going to change. I think just like most countries their national security is first and foremost for them and so they are going to continue to focus on that.

In terms of other international customers and any reaction to the change administration. I frankly haven't had any dialogue back from that as well. We -- as we bring in -- as we have an orderly transition of power in the United States of America, we have new leaders in the administration, they each -- they have different policies they might put forward, but it hasn't impacted our demand for our international products, a lot of our growth on international -- in the international marketplaces in the F-35, it's in missile defense, it's an opportunity for F-16 and C-130J, opportunities for C4ISR, Space awareness, things of that nature and that continue -- there continues to be a demand for those. And I -- as I -- as we continue to move forward in dealing with our international customers we're not seeing any retrenchment at all.

Bruce Tanner

Rich, you asked about the FMS and our direct commercial sale whether there was any discussions about potentially changing that are not. My suspicion is that's not high on anyone's agenda list at this point in time and I wouldn't expect to see any sort of policy changes towards that.

Just to put it in some perspective as we've talked about in the past, we would expect our FMS percentage of our international sales to grow and our direct commercial sale percentage of our international business to shrink over time, primarily simply because of the F-35 program and that program is a long way from ever having the ability to sell any aircraft on a direct commercial basis and essentially all the international customers and all the growth that you're going to see from international customers and the program going forward is going to be on the FMS side of the house.

And the same thing, frankly, is happening with our THAAD program, which is another large international grower. So that sort of squeezing out if you will the actual direct commercial sale business, actually direct commercial sales business isn't shrinking in absolute terms of all that much, but the percentage is reduced because of what I just described.

Operator

Our next question comes from Robert Stallard with Vertical Research. Your line is open.

Robert Stallard

Thanks so much. Good morning.

Bruce Tanner

Hi Rob.

Marillyn Hewson

Good morning.

Robert Stallard

Marillyn and Bruce, your comments on the F-35 program essentially seemed to suggest that nothing is really changing. But in the press we seem to see the DOD and the President taking a more aggressive stance. Is there a chance you are being too optimistic on this and the actual pricing on Lot 10 and beyond, and the margin could be lower than you expect?

Marillyn Hewson

Let me take that on since I have been a lot of discussions with President Trump. I only just going to frame it for you, I tried to express after those meetings, some overview of the meetings themselves, but I'll just give you a little bit more color on it.

Basically President Trump recognizes that the F-35 is a very large program, its largest program in the Department of Defense. He wants to make sure that that the American taxpayer is getting the lowest possible costs on the program and we share, we understand his concerns about affordability, we certainly share that. The meetings that we've had have been very productive, with very good dialogue. He asked excellent questions and he is really focused on making sure that that the cost comes down on the program and it is not about slashing our profit, it's not about our margins when we have those discussions about how we get the cost of the aircraft down today and in the future.

So I have welcome the opportunity to talk to him, because it gives me an opportunity to share with him what we have been doing in terms of bringing the cost down as you saw on the chart that we put in our deck today that we have been driving the cost down on the program that we have invested as ourselves and our industry partners in what’s called blueprint for affordability and we're moving forward on sustainment cost reduction initiatives, so that we can continue to take cost out of the supply chain, to take cost out of our manufacturing and produce ability and materials we use as we’ve moved along on this program.

And as we've done that we’ve -- I’ve also have the opportunity to share with him things that the Department of Defense can do and how they might buy the aircraft differently in the future that would help continue to drive the cost down, he open that discussion.

The other thing is very important that I'm happy to have the opportunity to chat with him about is the capabilities of the F-35 brings to our minimum and uniform, I mean, it’s basically a game changer, it brings for our country, for our military, as well as for our allies around the world unmatched capability, absolutely unmatched.

And recognizing that his focus is on how do we drive the cost down aggressively and we -- I think we are -- us along with our industry partners are right in line with him on doing that, we’ve got a lot of ideas on how we can do that in the future. In the meantime, we will continue on the current negotiations to come down that curve that you saw on the chart that we shared with you to continue to drive the cost down.

Operator

Our next question comes from Hunter Keay with Wolfe Research. Your line is open.

Hunter Keay

Thank you. Marillyn, just a follow-up to that last statement you made on the sustainment cost, are you talking about an incremental initiative here to reduce maybe some of the sustainment spending or is there may be an opposite way to think about that that as you manage this program for the next 10 years to 15 years for Lockheed that you can lower the unit cost, but perhaps, maybe recoup some of those upfront unit cost savings for DOD with actually higher sustainment revenues for you guys further down the road? How are you thinking about that balance?

Marillyn Hewson

Well, first of all, what I was discussing was the sustainment cost reduction initiatives, just like on blueprint for affordability which was focused on production costs, we along with Northrop Grumman and BAE committed some investment up front to help with getting projects underway that will continue to drive the cost down and production. We have similarly invested upfront to support the U.S. Government in driving sustainment costs down in the near-term over the next five years to drive that cost down.

So that was what I was referring to. Now your question about sustainment itself, I mean, we do look at these programs in terms of their overall lifecycle costs, which is not just the development and production but it's also sustainment and our goal is that the overall cost for the program would continue to come down.

Bruce Tanner

Hunter, maybe just to add one thing from my perspective and just to make sure that we are all clear on this. Sustainment is going to grow in the future. It has grown very significantly last few years as the aircraft is being based at various locations around the U.S. and soon to be internationally as well. So there is no doubt that sustainment will grow and the Lockheed Martin contribution towards that sustainment will grow into the future. This is about just doing sustainment smartly and doing it as economically as we can, but even if we do it is economically as we can we are still going to see some pretty significant sustainment growth in the future.

Operator

Our next question comes from Sam Pearlstein with Wells Fargo. Your line is open.

Sam Pearlstein

Good morning.

Bruce Tanner

Good morning, Sam.

Sam Pearlstein

You just talk a little bit about the backlog being $96 billion. I was wondering if you could talk a little bit about what your expectations are for 2017 year-end backlog and maybe highlight some of the key orders you are looking at, there was some international THAAD that didn't happen in '16 and just if you can talk a little bit about some of the key orders to watch?

Bruce Tanner

Yeah. So, thanks, Sam, there is, as we look at 2017 in all likelihood we are probably going to see a little bit of degradation in backlog. I would think maybe a couple million bucks or so for the year. Some of that is obviously dependent on, there is a couple of fairly good size competitive awards in 2017 that may or may not happen or may or may, at least may or may not happen in the year and in fact we may or may not win some of the proposals if you will.

The biggest drivers we have got in terms of orders and sort of keeping the backlog level as to where it is today are a little bit less than where it is today. You should think of that the ongoing advanced funding for the F-35 program. So very early in the first half of this year we should start receiving advanced funding for the LRIP 12 aircraft which will be a pretty good size increase in terms of absolute numbers of aircraft over LRIP 11.

As we just talked about with Hunter the sustainment and spares funding to support the bases around the country and the global is going to be increased in the first half of the year. We should start seeing additional GPS III satellite orders first half of the year and probably finalize the Hellfire order that didn't quite get finished last year and I expect that will take place early this year.

The really big orders in the year are the LRIP 11, definitization for F-35 that's -- we are assuming in numbers that we are going to get both LRIP 10 negotiated and definitized and LRIP 11 negotiated and definitized in 2017. We have already recognized a pretty good portion of the LRIP 10 contract via the [ph] U.K. (41:30) that Marillyn talked about, but not so much on the LRIP 11, so a big, big chunk of our orders in 2017 is associated with that definitization.

You mentioned the international missile defense programs I believe the largest one we're looking and again the second half of year is the THAAD Qatar program, so the first five of THAAD battery for the Government of Qatar is also a fairly large order in the second half. And then lastly, and I believe this is actually the second largest order for the corporation in 2017, but we do expect to close on the multiyear nine Black Hawk order in the second half of this year as well.

Operator

Our next question comes from Howard Rubel with Jefferies. Your line is open.

Howard Rubel

Thank you very much. Marillyn, you've gone through a number of significant changes in the last 12 months. And you indicated you and Bruce are going to be back to living a little bit more with normal. But could you for a moment step back and kind of talk a little bit about where are some of the competitive advantages you see and how you'd like to shape the company going forward, I mean, 25% of the company is F-35, but you do have a lot of other programs and a lot of other technology opportunities?

Marillyn Hewson

Thanks for the question, Howard. As I said in my prepared remarks on the front end, I think, we're extremely well-positioned for long-term success. Yes, last year was a challenging year in terms of transitioning the divestiture of IS&GS and really moving very far along in our integration with Sikorsky and that I would say a great tribute to the team is that despite those major efforts that we had going on in the business we exceeded all of our financial commitments, as well as actually hit some new records, I mean, I think, that's a true measure and our operational performance was outstanding in terms of how we are performing for our customer, so I'm extremely pleased with that.

In terms of strategically as we look forward, having Sikorsky as part of our company now, it opens up a lot of opportunities for us, we are currently in the development phase for a number of helicopter program, so we are going to move into production, so as you look at the CH-53K at the Presidential Helicopter, the work we've been doing on the Canadian Maritime Helicopter program, the combat rescue helicopter that we're working, all of those programs, as well as what Bruce mentioned, we continuing on with the Black Hawk and getting into the next year multiyear Black Hawk is excellent growth area for us that will continue to bring good cash generation and continued growth for us as the company.

And then we do expect at some point the commercial business will come back, we are at a lull right now with the oil and gas prices, but it's another opportunity for growth for us and one of the elements of the company that we'll look forward to continuing to grow. And so, Sikorsky has been a great asset that we brought into the company and I see great growth opportunities. We've talked about 35 at length, you can see, certainly it is a growth engine for our company and we continue to see growing international demand for it, so it's not just a program of record that we have with the U.S. Government on the services that are buying the aircraft, but and the international partners that have already signed up, but many other countries are showing interest in the program.

And then across the portfolio from our missile defense to the work we are doing in mission systems and training to all the elements of our fire control capability, our space systems and satellite and spacecraft. I think if you look holistically at our portfolio we are very strong in all of those areas and represent a leader in and virtually every one of those markets. So from a competitive advantage standpoint I think our goal is to continue to perform with excellence on the programs that we have today and to continue to look for opportunities to keep our portfolio relevant to continue to invest in research and development and innovation so that we stay on the forefront.

I think innovation for us is the lifeline of this company. What we're doing in our independent research and development, what we're providing to our current customers and what we're looking at and providing for long-term investments for the long-term and things like hypersonic and directed energy and other things. And then as you're probably aware we set up a venture fund where we're also taking positions in companies that we see is another seeding of our innovation into our company.

I would lastly say that from a competitive advantage standpoint my view is that that it is the talent in this company that is the competitive advantage. We have the best talent in the industry in my view from and that in my view sets us apart. So that couple with the technology and the outstanding portfolio, I think, sets us up very well for continued success and continued growth.

Operator

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

Myles Walton

Thanks. Marillyn, it sounds like border taxation was discussed during your meeting yesterday with other business leaders and I'm just curious as it applies to your own business and to the defense landscape, do you have a sense as to -- a clear sense as to how this is going to impact your business in the sector, does it sound like the President is a supporter of no tax on exports and could you just describe how it would impact Lockheed the way you see it? Thanks.

Marillyn Hewson

Thanks for the question, Myles. And I guess, I would step back from his yesterday and what you’ve heard from him in his campaign is that his focus is on not having work go offshore to be produced and then brought back into the United States that are -- and have the company have the advantage of producing it elsewhere. So if you take the Lockheed Martin, I mean, we are not, we produce our products in the U.S., predominantly of our roughly [ph] 98,000 (48:04) employees over 90,000 are here in the U.S. This is where we produce our products and then we deliver them around the world.

And those that are producing another parts of the world whether it’s in the U.K. or in Canada or Australia, the work that we might be doing there is not being imported back into the U.S. So I don't see that this border taxation issue affects us as a company and I think it’s more geared toward commercial companies that might decide to do the production offshore and then sell their products back into the U.S.

Bruce Tanner

Yeah. May be Myles just to add it from my perspective, so anytime you're talking about reducing taxes on exports, we’re -- we have a fairly good amount of exports and we don't frankly import a whole lot, so we would probably be a net benefiter from a tax perspective relative to that were to happen.

I think if you look at either one of the tax proposal as sort of being tossed around. The current one you just discussed, as well as the one that the house put forward later or earlier, excuse me, middle part of last year or so.

In virtually either one of those scenarios the statutory rate drops pretty significantly and for Lockheed Martin the U.S. domiciled company with most of our income, as Marilyn said, coming from U.S. locations. We don't have the sort of offshore issues that a lot of the global companies would and so we would be a benefiter or benefactor probably either one of those tax policies going forward.

Operator

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

Noah Poponak

Hey. Good morning, everyone.

Marillyn Hewson

Good morning.

Bruce Tanner

Hi, Noah.

Noah Poponak

Marillyn, I wanted to ask if you could maybe provide a little more detail or I guess thought around the total U.S. defense budget commentary you touched on briefly in your prepared remarks. I mean, I guess, where would [ph] Japan (50:16) the actual likelihood that sequestration is removed from DOD versus the need to have some kind of compromise where they, I guess, still, I guess, I'm not as sure, but still seemingly still deficit focused Congress and if this is happening will we see it in the '18 request or does the administration need another year and half to have it be fully their own and be prepared to do that?

Marillyn Hewson

Thanks for the question, Noah. I guess, I will just give you my opinion because that's really all I can do at this point is pretty unpredictable as we go forward and as you indicated. My opinion is though that there's appears to be bipartisan support for eliminating sequestration. As I've said in the past, we have a lot of independent dialogues with various members of Congress, every one I've ever spoken to [Technical Difficulty] they don't think it's good policy and they want to get rid of it.

So I think now with the current Congress and the new administration that it probably opens up the opportunity for really getting that done and I'm very encouraged that the dialogue has been around eliminating the defense sequester, just removing it altogether and there's also a strong discussion around increasing defense spending, because we have for the last few years allowed our -- with that budget caps et cetera, we have not been investing like we need to in recapitalization and then and readiness and a lot of things that you hit directly from our customers, our services telling Congress and telling the new administration that they need.

So we are very supportive of our defense customers and being a voice around that, because we do think it's important to eliminate the sequester and the budget caps associated with it to allow them to do, to address the national security strategies and to provide a right capability for minimum and uniform.

In terms of where it might come into play, I mean, I -- again, I'm encouraged by the fact that there is some discussions around supplemental to the FY17 budget, there's some discussions around getting after this whole issue of sequester and eliminating the budget caps. So whether it’s in ’18 request or in the early ’17, it’s hard for me to predict, but I think it will be near-term and longer term, because everyone that I speak to has recognized and certainly President Trump has recognized that it's something that needs to go away and we need to get on with spending the appropriate amount, having adequate budgets to support our national security.

Operator

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

Jason Gursky

Good morning, everyone. Bruce, Marillyn, I was wondering if you wouldn't do us a favor and walk through each of the segments and maybe provide a little bit of color on the risks and opportunities this year relative to your official outlook?

Marillyn Hewson

Thanks, Jason. Let -- Bruce why don’t you walk through and then if I have anything to add on.

Bruce Tanner

Yeah. Let me do that and Jason, if I don’t quite capture what you are looking for get back and shout out at me there. But maybe just starting with Aeronautics, largest business, obviously, portfolio. So on the sales side we’re expecting sequential growth quarter-over-quarter, so fourth quarter will be the highest quarter of the year first quarter as is typical in Aeronautics will be the lowest quarter of the year.

From sort of the comparison to 2016, I would expect sort of the rate of growth or the percentage of growth over ‘16 to sort of diminish a little bit as we go through the year even though the numbers will get bigger and that's in part because we are going to see a little bit albeit the F-16 program comes to an end in the late second quarter or early third quarter, if this is the last eight aircraft deliveries that we have in backlog right now and until we get another country to buy the F-16 that will be the last those production aircraft, so that’s going to be a little bit lower in the second half of the year than the first half, but still pretty significant growth quarter-over-quarter for Aeronautics and obviously most of that driven by the F-35 program.

I think EBIT during the year probably follows the sales volume as we look at least right now pretty consistent margins quarter-over-quarter, that obviously, it is dependent upon when we have the timing of risk retirements occurring throughout the year, but with the planned risk retirements we have in the outlook right now it says that the margins are fairly consistent going throughout the year.

May be jumping to missiles and fire control, expect the first quarter to be maybe a little bit lower than perhaps you're expecting, first quarter is going to be quite a bit lower than the rest of the other three quarters of the year, you should think of that as the timing of deliveries that had both and especially if you are comparing it to the fourth quarter of 2016 we had a lot more deliveries in the second half of 2016 and we expect to see in the first quarter of 2017, and so that drop off you'll notice I think when we come out with our results at the end of the first quarter.

The next three quarters are quite a bit higher than the fourth quarter and they are actually pretty consistent as we look at the outlook right here for the next year or so, low in the first quarter, next three much higher and the next three fairly consistent with each other.

Similar to Aeronautics, the EBIT kind of follows the sales volume because we do expect a fairly consistent margin between quarters in 2017. Rotary and Mission Systems 2017 kind of similar to Aeronautics, we do expect sequential growth quarter-over-quarter. Probably, also EBIT tracking for sales but we also expect that the margin quarter-over-quarter will increase, so we'll see some increases as we go throughout the year within the margins within RMS and this is a little bit of the wind down of some of the purchase accounting and intangible -- not intangible amortization but the integration costs associate with Sikorsky, as well as the timing of some of our planned risk retirements in 2017 causing that effect.

And then, lastly, Space, in 2017 actually almost draw straight line across the quarters, roughly $2.2 billion there about every single quarter of the year is what we are expecting. There's no commercial launches or commercial satellites with sales that we would book upon delivery like we had in 2016. We actually had two commercial launches all in the year and we have zero plan for this year, so you won’t kind of see the spike associate with those deliveries as we saw in 2016 so I am a little more consistent there.

EBIT again kind of follow sales volume is probably little more variability than that and this is really associate with the timing of equity earnings as we progressed throughout the year. So hopefully that captures that in terms of how we look at that. Obviously, as we look at the year and I always give this speech at the start of, it's seems every year, that's based on the opportunities that are built into our plan.

And as I always like to say, as we look at the opportunities in 2017 and compare those to what we saw in 2016, the potential for doing better is about the same as what we saw in 2016 or for that matter in 2015 but we have to make that happen in 2017 for that to come to fruition and again that's not in the numbers or the planning that we just talked about to you.

Greg Gardner

Stephanie, I believe we have time for one more question.

Operator

Our final question comes from Robert Spingarn with Credit Suisse. Your line is open.

Robert Spingarn

Good morning. Thanks for squeezing me in. Just a couple of cleanup things on F-35, Marillyn, if we go back to the sustainment discussion, in your discussion, in your negotiations with DOD on LRIP 10 and on anything else, has there been any consideration to defer future competition for either F-35 sustainment or for the Block 4 subsystem upgrade work? And Bruce, how is this potential competition contemplated in your long-term outlook for the aircraft? And then the last thing I wanted to ask you is how important is the 450 unit international block buy to the margin growth cadence that you described to Ron earlier?

Marillyn Hewson

Thanks for the question, Rob. I guess, the first question on sustainment, sustainment is a separate contract from the LRIP 10, so it isn't part of the discussion at all in LRIP 10 negotiations nor would be the upgrade work for Block 4 going forward…

Robert Spingarn

But might they factor into any horse trading or anything that you all are talking about?

Marillyn Hewson

Actually no we treat them separately as separate contracts, we look at what the sustainment contract is versus the LRIP 10, I mean, there are just, the separate LRIP 10 is pretty straightforward, as we look at our assessment of the costs associated with LRIP 10 and offer that we put forward based on the cost of the aircraft and the terms and conditions associated with that contract. It doesn't include sustainment.

Bruce Tanner

Rob, let me try, I jotted down your questions. Hopefully, I captured them well. But as far as the future competition for sustainment block, if that happens and look competition is the buzzword that everyone talks about these days. We are not afraid of competition. We think the legacy of performance that we have both with the software development on the program, as well as what we've done so far in sustainment and we -- what we plan to do with as Marillyn said, some of the cost reduction initiatives on sustainment. We think we are incredibly well-positioned in both of those if in fact they are competed and our assumption would be that we would win those competitions and that is embedded in our planning if you will.

I think you also asked about the block buy and the importance of the 450 aircrafts, potential block buy relative to margins. Not so much benefit on the margins that we are contemplating, Rob, as much as helping secure long-term commitments from suppliers, long-term planning for our own work inside our own factory such that can hopefully get and with the benefits are sort of an economic order quantity associated with that block buy that we can get the price of the aircraft or the cost of the aircraft down just as what Marillyn’s talked about relative to her conversations with the President. I mean that is one of the items that was addressed in those conversations is what can we and the government do to get the cost of the aircraft down and that is clearly one of the things that can do that.

You get -- if you look at any sort of multiyear or block buy or economic order quantity, there are always savings associated with that, the only question is how much are those savings and we think we have a very good plan in place relative to the block buy to bring the cost down going forward. But I wouldn’t expect that that expectation on our part of lower cost would be sort of priced in to that block buy if you will. So I wouldn’t expect to see necessarily margin spike associate with that.

Marillyn Hewson

So with that -- with our last question let me conclude the call today. I want to end up the call by just reiterating that 2016 was truly an extraordinary year of transition and success, and our team performed exceptionally well in all phases, strategically, operationally and financially. As we look into 2017, our strong backlog and solid portfolio have the corporation positioned for bright future of topline growth and increasing cash flows. Thank you again for joining us on the call today. We look forward to speaking you at our next earnings call in April. Stephanie, that concludes our call today.