Good day, and welcome everyone to the Lockheed Martin First Quarter 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. Jerry Kircher, Vice President of Investor Relations. Please go ahead, sir.

Jerry Kircher

Thank you, Abigail, and good morning, everyone. I'd like to welcome you to our first quarter 2016 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 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're pleased to have you with us as we review our first quarter results and full year outlook for 2016.

As today's release details, we had a very strong quarter financially and operationally. The Corporation continued to perform at a very high level in delivering critical solutions to customers while returning value to stockholders. I want to highlight a few key items in the quarter, including an update on our Sikorsky activities as well as the current status of the strategic disposition of our Information Systems & Global Solutions business to Leidos.

Turning to the quarter. Our team continued to deliver broad based results across the Corporation, with achievement of first quarter financials that exceeded all of our internal plans. This strong year-to-date performance enabled us to increase full year 2016 guidance for sales, segment operating profit, earnings per share and cash from operations. As a reminder, the guidance continues to assume inclusion of full year 2016 financial results from the Information Systems & Global Solutions business. We will adjust our financial outlook when the disposition of IS&GS is completed, which we continue to anticipate will be in the third or fourth quarter of this year.

Bruce will provide a detailed review of the guidance and assumptions in his comments and web charts. One of the standout items in our financial results is the strong performance of cash from operations. Consistent cash generation is a financial hallmark of our Corporation and enabled us to return over $1 billion to stockholders this quarter through dividends and share repurchases.

I would also note that share repurchases year to date have reduced the outstanding share count to approximately 304 million shares and this lower level illustrates the progress we are achieving on our goal to reduce outstanding shares to below 300 million by the end of 2017.

This longstanding goal does not consider the additional share reduction opportunities from the pending disposition of IS&GS. We anticipate further share reductions will be accomplished by a stock exchange contained in the deal transaction. Additionally, the $1.8 billion special cash payment to our Corporation at deal closure also provides cash deployment and share reduction opportunities.

For the full year of Sikorsky operating as part of our Mission Systems and Training business area, I'd like to offer my high level perspective on their activities. Integration actions are progressing well as we work to transition Sikorsky operations into Lockheed Martin. As we perform the integration, we continue to evaluate the best-in-class processes, procedures and tools. Our goal remains to identify and apply the best practices across the enterprise throughout the integration process.

We continue to see cost reduction and efficiency opportunities emerging as we work as one team with Sikorsky. Areas like supply chain where multiple business areas procure similar materials have allowed us to look at where we can realize better buying power and align procurement specifications. By utilizing best-in-class processes from across the Corporation, further efficiencies can be achieved and will help ensure we capture the synergies identified from this acquisition.

Moving to an operational perspective. Significant progress was achieved on the CH-53K program for the US Marine Corps. The second prototype test helicopter achieved first flight in February, providing additional assets to the flight test program and expanded our ability to achieve future critical milestones. We look forward to demonstrating the maturity of the aircraft through the current development phase.

Since the end of the quarter, we received a contract from the US Navy for long lead items required for the first two CH-53K helicopters on low rate initial production Lot 1. These initial units are part of the naval aviation procurement plan to field 200 helicopters on the program in coming years.

In the area of commercial helicopters, we're seeing some emerging interest from other customers beyond the oil and gas sector for S-92 platforms and we are pushing aggressively into the search and rescue, VIP transportation and international military segments.

We also see a significant potential to create additional value in these sectors in sustainment. To pursue this area, we recently opened a state-of-the-art customer care center in Connecticut, that is designed to enhance platform reliability and ensure 24-hour availability to customers’ aircraft needs. Overall, I remain enthusiastic about the opportunities for long term creation of the rotary aircraft business to customers around the world.

Turning to our Information Systems & Global Solutions business area. Key events associated with the pending. strategic disposition included successful clearance of the Hart-Scott-Rodino regulatory review in the United States, satisfying one of the key conditions to deal closure. The only remaining review of competition impact is in process in the United Kingdom.

We also filed the required registration statements last week with the Securities Exchange Commission. This filing and a comparable filing by Leidos initiate a review process by the SEC staff. Once the review process is completed, a prospectus describing the terms and conditions of the exchange offer and transaction will be provided to Lockheed Martin stockholders.

Switching to some brief comments on the F-35 Joint Strike Fighter. Overall the program continues to progress on satisfying remaining development activities while also ramping up the production rate. Several noteworthy events were achieved this quarter and included completion of the first Transatlantic F-35 flight from the Italian final assembly and checkout facility to the US to enable commencement of training for Italian pilots, surpassing 50,000 flight hours of the F-35 fleet, demonstrating the increasing level of flight operations.

And lastly, we also successfully conducted first flight of the software required to achieve initial operational capability of CTOL aircraft to US Air Force. Achievement of this milestone enables the program to progress towards IOC scheduled later this year.

I will conclude my remarks by recognizing the difficult but necessary workforce reduction actions implemented this quarter by our aeronautics and IS&GS business areas. As stewards of the enterprise, it is a business imperative that we remain agile and competitive in our cost structure.

In response to dynamic business conditions, these businesses implemented voluntary and involuntary headcount reductions. While these reductions resulted in a special severance charge in the quarter, they also significantly improved our competitiveness and ability to win future new business opportunities with a leaner cost structure.

I'll now turn the call over to Bruce to review our financial performance in more detail 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 web charts we included with our earnings release today.

Let's begin with chart 3, and an overview of our results for the quarter. Sales for the quarter were $11.7 billion, slightly ahead of our expectations. Segment operating profit was also higher than expected at $1.2 billion, resulting in earnings per share of $2.58 which included the impact of about $100 million in severance charges associated with planned headcount reductions.

We generated $1.6 billion in cash from operations, a good start to the year. We returned $1 billion of cash to our stockholders in the quarter, about equally split between share repurchases and dividends. And because of our better than expected performance, we are increasing our outlook for sales, operating profit, earnings per share and cash from operations. So we're off to a strong start in 2016.

On chart 4 we compare our sales and earnings per share in the first quarter of this year with last year's results. Sales were about $1.6 billion higher this year than last year, driven by the inclusion of Sikorsky into the results of MST for about $1 billion -- and more than $600 million in growth at Aeronautics driven by about $400 million in higher F-35 production volume along with higher C-130 and C-5 aircraft deliveries.

Earnings per share were lower than last year, but this year's results include the severance charges for reductions in Aeronautics and IS&GS, as well as the headwind effects of the Sikorsky purchase accounting adjustment and integration costs.

On chart 5, we will discuss the cash return to our shareholders in the quarter. With nearly $1.6 billion of cash from operations and slightly more than $150 million of capital expenditures, we had $1.4 billion of free cash flow this quarter. And with over $500 million each in share repurchases and dividends, our total cash returned to shareholders was 73% of free cash flow. With our share repurchase level in the first quarter we are right on track to our plan level of $2 billion in share repurchases for the year.

If you will turn to chart 6, we will provide our updated outlook for 2016. Because of our strong performance in the quarter we are increasing our yearly outlook for all key financial metrics. We are increasing our sales outlook by $100 million and our segment operating profit outlook by $125 million due to our performance in the first quarter. We are increasing our earnings per share range by $0.05 per share and I will discuss that in greater detail on the next chart. And we increased our outlook for cash from operations by $100 million, consistent with our improved profit outlook.

Chart 7 provides a reconciliation of our current and prior earnings per share outlook. The $125 million increase in segment operating profit results in a $0.26 increase in EPS while the $100 million special charge associated with our severance actions reduces our EPS outlook by $0.21, netting to the $0.05 increase that I mentioned on the prior chart.

On chart 8, we show our revised sales outlook by business area. The $100 million increase in sales is due to the improved outlook we have for IS&GS after its better-than-expected results in the first quarter. We are reaffirming the sales ranges for the other four business areas at this time.

Chart 9 provides the updated segment operating profit outlook by business area. We increased our operating profit outlook in four of our five business areas with Aeronautics, Space Systems and IS&GS increasing $25 million each while Mission Systems and Training was increased by $50 million.

And finally on chart 10, we have our summary. Our strong start to the year led us to increase the outlook for sales, operating profit, earnings per share and cash from operations. We continue to provide significant cash returns to our stockowners and we remain on track to complete the IS&GS RMT transaction later this year.

With that, we are ready for questions, Abigail.

Question-and-Answer Session

Operator

[Operator Instructions] Our first question comes from Carter Copeland of Barclays.

Carter Copeland

Hey, good morning, Marillyn, Bruce. Good quarter. A couple of just quick ones on the margin. I noticed that the profit contribution from the C-130 that you called out on the $200 million and higher revenues is only $10 million and sort of implies a lower margin than we would think is normal for that. I wondered if there was a negative offset there? And then as a second one, in the guide I noted the sales in MFC have obviously been strong and benefited from I think some of the consumable stuff and some of the stuff you highlighted in the release. But the guidance didn't increase there and I wondered if there was again an offset to call out for the full year. Thank you.

Bruce Tanner

Thanks, Carter, thanks for the question. So the first one I think was your margin contribution question relative to C-130. And you picked up right. I think we had a $190 million increase in sales and about a $10 million or so increase in profit is what we called out I think on the earnings release. This is somewhat of what I talked about I think either in October or January where we are sort of finishing kind of an older, I would say, multi-year contract – it's more than a multiyear contract, but an older contract of C-130s that we performed well on. And it's at the tail end of that contract and we are starting off with sort of the new deliveries and new performance on the new multiyear contract that was just negotiated. So some of that is sort of the resetting, in my words, of the profits -- initial profit booking rate on the C-130 contract. As I have said all along, I still think the economics between the two contracts are very similar. But as is our sort of historical practice, we are starting that program a little lower than we ended the last program for C-130s, if that makes sense.

On Missiles and Fire Control sales, you are right. We did not increase for the year. We are watching that closely. I will just leave it that as we sit here in the first quarter didn't feel like now is the right time to look at that. I think there is some upside opportunity. We have seen some good signs particularly, as you said, Carter, in some of the consumables particularly with some of our Middle East customers. But I am watching this to see if it perhaps warrants something later on in the year, but not at this time.

Operator

Thank you. Our next question comes from Doug Harned with Bernstein.

Doug Harned

Thank you. I'd just like to follow up on the Missiles and Fire Control side, because you also in the release talked about it sounded like more a timing issue with contracts on missile defense, you referred to PAC-3. Can you talk about when you look at international contracts, particularly in the Middle East on missile defense, where you stand today in terms of the maturity of those programs? Because it appears you may be in some that are earlier stage and perhaps lower margin at this point than when they mature.

Bruce Tanner

Doug, I will give that a shot. So I think the watch item in terms of the air missile defense programs for the Middle East are more in the orders expectation for this year rather than I will say the margin expectations. You should think of essentially all of international orders for both PAC-3 missiles as well as the THAAD program are sort of combined with US orders. So they will perform essentially at parity with US orders over that period of time. There is not per se any greater risk associated with the Middle East portion of the order than the US military portion of the order, if you will. And this again is somewhat akin to what I talked about just now in the C-130 where we have sort of a shifting from an older contract where we closed out a good performing contract and a newly negotiated contract where we are starting off at our typical pattern, probably a little more conservative than we expect to make. And that’s exactly what’s going on in both PAC-3 and THAAD programs as we negotiated some new contracts and they are starting off slightly lower margin than what we experienced at the end of the previous contracts that finished up.

Again, economically I'm not sure there is a whole lot of difference between the contracts, but sort of from a booking perspective that’s the way that is playing out. But I wouldn't attribute that necessarily to any greater perception of risk that we have associated with those deliveries.

Operator

Thank you. Our next question comes from Richard Safran of Buckingham Research.

Richard Safran

Thanks, good morning. I had a bit of a multipart question here on trying to get an update on the F-35 margin profile we should expect. So in 2016 I think you are north of about 8%. As you ramp up production and some of the low margin development work winds down, I want to know if you could comment on what the margin progression should be. How quickly do you think you can get to F-16 types of margins? And if you would, could you comment on F-35 sustainment and if that could drive upside to margins?

Bruce Tanner

Hey Rich, I will take that one as well. So, F-35 margins are going to vary over time. I think from a big picture perspective we do expect them to increase sequentially year over year. We talked about last year being an expectation of a 100 basis point improvement in the overall margins of the F-35 program. We achieved that. I think I talked about again either October or January the fact that we thought margins on F-35 would be higher in 2016 than 2015. We still expect that although not at the same 100 basis point improvement as we saw in 2015. And we would expect that trend to continue in 2017 and 2018 as we start to sort of progress to what you are describing, Rich, which is our ultimate expectation, which is that by the time we get to full rate production the margins on the F-35 program look very, very similar at a very similar stage of its life cycle as F-16 margins, F-22 margins, C-130, et cetera.

So, I don't think that we are deviating from that expectation. Interestingly, as I look at some of the numbers in front of me here, we had probably slightly higher pickups on the production program last year in the first quarter than we did this year, although we did have profit step ups on production contracts this quarter as well. If I look at last year's first-quarter results -- and I know I didn't talk about this last year -- we were actually close to 10% on the production program. So, it will sort of peak and valley depending on the step ups and when they occur and how many of them occur on multiple production contracts in the same quarter. But our expectation again is we will get to sort of legacy program margins when we get to full rate production.

Your second question was on the F-35 sustainment margin. Those are typically negotiated at pretty comparable margin levels as the production program. So it’s not at this point sort of either a drag or a benefit at this point in time. It is growing fairly rapidly and we are going to start seeing some of the sustainment contract sort of split out of the production contracts as this volume gets bigger. So we may in the future end up talking about sustainment separately from production. But you shouldn't think of that as being a whole lot different than the production margins at this point.

Operator

Thank you. Our next question comes from Joseph DeNardi with Stifel.

Joseph DeNardi

Bruce, I wonder if you could just talk about kind of Sikorsky performance relative to expectations at this point from a revenue and margin standpoint. And then also, just as you look into 2018, I think that’s when the required contributions start again for the pensions. So just based on current assumptions can you talk about what the contribution could be in 2018?

Bruce Tanner

Sure, Joe. Thanks for the question. So I would say Sikorsky -- and look, we are still early into the integration and into the incorporation of Sikorsky into our results. So I am still getting my head around describing Sikorsky and what the expectation should be and shouldn't be. I would characterize the first quarter as pretty much in line, maybe slightly better than our expectations. That's both from a revenue perspective as well as a margin perspective or an EBIT perspective. We are sort of front end loaded during the year with these things I talked about in the last quarter's call, these customer lien rights that have sort of depressed the sales because of sales for products that were recognized prior to our ownership. That plays out sort of for the most part in the first half of this year. So we would expect to see sort of sequential growth in sales at Sikorsky quarter over quarter with the fourth quarter obviously being the highest quarter of the year.

Similarly, we expect to have the margin profile for Sikorsky increased quarter over quarter, again obviously having the fourth quarter being the highest margin quarter as well. And this is again some of the timing of the customer lien rights in the first half of the year as well. So I'd say just big picture, that's pretty much in line with what we expected to happen in the first quarter, and we're going to watch it throughout the year, we'll give you updates as we go and progress through the rest of the year.

Secondly, Joe, you asked the question about 2018 pension funding. So we had described several years ago our expectation that we were going to have a three year pension holiday – cash funding holidays I called it, I think and that was 2015, '16, '17, and unfortunately that holiday does stop at the end of 2017 and in 2018 we would expect to have to start making cash contributions to the pension plan as well going forward. I think as we sit here today, Joe, that's probably somewhere north of probably $1.5 billion or so. But importantly, I think you shouldn't think of that as necessarily being sort of taking the current run rate of cash and subtracting, so say, $5 billion and subtracting $1.5 billion, and we're down to $3.5 billion. We expect by 2018 to have much greater cash from the Sikorsky acquisition as well as cash from the other business areas that's going to offset most but not all of that pension contribution. And we also get a tax benefit of that as well. So we get a cash tax benefit associated with that. So it's somewhat mitigated in 2018, so you shouldn't think of as sort of falling off the cliff from 2017.

Operator

Thank you. Our next question comes from Ron Epstein with Bank of America.

Ron Epstein

Good morning. Can you just walk through the laundry list of upcoming competitions that we should keep an eye on? I mean, we all kind of know Trainer [ph] is happening and maybe you can make some commentary on that. But what's on that list of stuff we should keep our eyes out for?

Bruce Tanner

Hi Ron, this is Bruce. Did you say competitions or just bigger awards coming up or do you –

Ron Epstein

No, competitions, yes, competitions, right. So we have got Trainer and what else do we have on the horizon?

Bruce Tanner

You know, there is not a whole lot of – I'll say large dollar strategic competitions coming up, even Trainer is likely going to be -- the decision is likely going to happen in 2017 as opposed to 2016. Another large one that we are watching is JSTARS, but that's probably not a 2016 decision either. Most -- frankly most of the -- I will say the strategic competitions that I think is at the heart of your questions would probably not be in 2016. I mean these are things like long range -- or the LRSO competition, the TBMD -- GSBD, excuse me ground strategic ballistic deterrent. But those are probably '17 and even beyond as far as the real big pick of strategic items. And beyond that, I mean the one we are watching obviously closely, which I wouldn't characterize as a competition, but MEADS in Germany is one that we are hoping to close perhaps at the latter part of the year. And I'll let Marillyn add some color to what I've just said.

Marillyn Hewson

The only other ones I would say that we are watching are some of our international partners making their decision on F-35 buys. So Denmark is coming -- they are going through their process and Canada will ultimately. But we think the best choice for them is F-35, but they will go through their process for that.

Operator

Our next question comes from the line of Robert Spingarn with Credit Suisse.

Robert Spingarn

Good morning. I wanted to ask really a two part question on IS&GS if I could. First, I think as you both stated, the business is doing a little better than perhaps you guided for and you have tweaked up the guidance there. So wanted to talk about whether that is just timing on some of these program closeouts or pricing environment which I think you cited pressure in. Maybe it's little better than expected.

And then separately, Marillyn, the deal was contemplated I think on what the business will look like at the time of transaction. But of course that's a nine-month period. And so, from the time of announcement, how do we think about some of the puts and takes and strategic things that you are doing with regard to headcount vis-à-vis that new management team? Are these things that were negotiated? How do we think about that? Thank you.

Bruce Tanner

Well, let me take the first part of that question, sort of the IS&GS performance. And I will say I mean obviously we increased the outlook for both sales and profit. So it's exceeded our expectations. I think there is a couple of things going on and some of them are a little subtle. So sales is just -- this is a tough business to sort of predict what -- which competitions are you going to win, which ones are you going to not win. And you get scenarios where things get protested even if you lose and therefore you can actually get the sales stretch out of those. We are sort of seeing all those happen at the same time.

The one thing I am really pleased with probably more than anything, even higher than sort of the sales volume because, again, that's a little bit hard to call, is the better-than-expected earnings performance and the margin performance. This was a quarter where we had a pretty significant write off on an international contract. And even with that write off we still exceeded our expectations and we still, as obviously we said earlier, increased our guidance for the year. I think that's sort of due to three reasons, at least as I look at it sort of big picture wise.

One, we had expected a number of re-compete activities to occur on some of our larger contracts in the year. And these, we bid those probably more aggressive than the previous contract where we were the incumbent. And because these contracts are actually being protested we are continuing the performance on the older contracts which are at the -- if you will, the higher margin on the incumbent contract. So it's good for us from both a sales perspective and more importantly on the margin side because of that.

I think we also had better performance on sort of the closeout or transition of some of the programs that we lost. So you should think that most of these contracts tend to have transition periods that extend for some period of time. We are actually performing very, very well on those transition periods. And taking some cost out as we end the program higher than our expectations which are resulting in higher margins.

And then the third thing I would just say is really just across the portfolio, strong performance by the IS&GS team. And I think credit goes to that team. I think it's indicative of the fact that they haven't taken their eyes off the ball. It's a well-run organization and the entire team understands that the mission that they perform for their customers is important no matter who they work for. And I think we are seeing that play out live and in person in front of us here. I will ask Marillyn to answer the other question you asked, Robert.

Marillyn Hewson

Yes, I will pick up on the second part where you asked about at the time of transaction how to think about some of the puts and takes and the headcount and how we think about it. First, I just want to build on what Bruce said. I mean this is a management team that's running a business. They have outlined some commitments for the year and they are performing the commitments and the whole entire team in IS&GS is making sure that their cost structure is in line with the business base that they have. So, as they look at what they need to do to be competitive in a very competitive environment that they operate in it is ultracompetitive. And it's an area that you have got to constantly be watching your cost and you have to manage to that.

There is close coordination with Leidos as they make headcount reductions. Certainly we have an agreement as we are going through this process to closing the transaction. So actions that we take on the Lockheed Martin side, they are aware that we are going to take those kinds of actions. But it is our job to continue to run the business to perform well on the business. It's in all of our best interest and we will continue to do that with an excellent team that's working that every day.

Operator

Our next question comes from David Strauss with UBS.

David Strauss

A couple questions within one, I guess. First, can you talk about only six F-35s that were delivered in the quarter? Was that your plan or was that actually below your plan? And then on Sikorsky, can you talk about -- it looks like MST that you are guiding for fairly flat EBIT from here through the rest of the year. But I would think, as you have commented, Sikorsky is expected to get better. And whether you are still tracking a plan for Sikorsky as a neutral to earnings in 2017? Thanks.

Bruce Tanner

Thanks, David, good questions. So the six F-35s probably a little lighter than we expected and there is probably three or four different reasons for that. But none of them that will play out I think. By the time we get to the end of the second quarter I think we will be back on track at the end of the second quarter. And we are very much on track to have the 53 aircraft that we talked about in the first quarter or the last call in January, excuse me, delivered for the year. So no issue there. Some of it was just sort of the transition between lots and getting new acceptance for new software and the like that delayed some of the deliveries. But sort of from a production or manufacturing side there is no issue there, it was more of a, I'll say not quite administrative but not a production issue there.

You talked about Sikorsky within MST and guidance looks like sort of flat earnings for the rest of the year. That’s what we are showing, David, in the outlook there. And even with the $50 million increase in guidance from an earnings perspective with MST, that’s one that we are still watching closely. It’s a little early in the year to go more than that, but I think there is some potential upside in the numbers that we have got on the table right now. If you just do the math the way you did it, David, with including the Sikorsky uptick for the rest of the three quarters of the year you'd kind of come to that conclusion I think as well.

And then lastly I think the Sikorsky -- you asked about Sikorsky being neutral in EPS. So all this has to do with the share reduction from the Reverse Morris Trust transaction and expectation of some of the bleed off of the transition costs or transaction costs including the integration. That’s still our expectation, David, is that will be neutral going into 2017 with all of the pluses and minuses going into that.

Operator

Our next question comes from Peter Arment with Sterne Agee.

Peter Arment

Bruce, a question on kind of just big picture on the backlog. You closed in 2015 at a record level and then we had a little bit of a downtick here this quarter, I guess timing related. On IS&GS you are going to lose that. Is there a number that we kind of should be looking for, for where you think backlog ends up at the end of the year? And then just, Marillyn, if I could -- related to that, how are you looking at kind of the international front? We have seen a healthy drop in oil over the last 18 months. We haven't seen a big impact on your awards, but just seeing if you are seeing any behavioral changes. Thanks.

Bruce Tanner

So, Peter, I will answer the backlog question. So, we were down in the quarter after the record backlog at the end of last year. Actually we were ahead of plan in the first quarter, I think a couple billion dollars worth or so. So that may not be apparent; even though it was down, it was not down as much as what our plan had suggested it might be. An interesting thing, we are going to have probably a little bit of an opposite or unusual pattern to backlog this year, at least as we see it, the orders this year. We are probably not going to have as large a fourth quarter from an orders perspective as we ordinarily would. The largest quarter is actually third quarter this year and that’s sort of the planning and the biggest single ticket item there is the definitization or award of the LRIP 10 contract on F-35 and that’s worth a significant amount of money.

Depending on when that happens and when IS&GS' disposition we could actually see potentially $100 billion worth of backlog that will quickly dissipate with IS&GS' disposition. And if I was to pick a number it’s probably going to be somewhere between $90 billion and -- low $90 billion to $95 billion by year end is the expectation. We were sort of expecting at about almost $4.5 billion or so, $5 billion drop, steady run rate with IS&GS in the mix. And when you take out IS&GS it gets down to that $90-ish billion level.

Marillyn Hewson

And Peter, I will pick up on your question relative to impact of oil prices and what it might -- what we are seeing on our awards. We often talk about this because we are trying to watch. We are not seeing a pullback on essential national security assets and what these countries need. What we are seeing is that there is a couple of them that we are watching. And particularly one that’s in our numbers and that we are watching very closely is the Qatar THAAD order because that’s something that we are hoping to have in this year and it is in our plan -- it could potentially delay.

I think it’s not an indication they are not going to buy it. To me it’s just a matter of them balancing with pressure on their budgets with oil prices, balancing what they can buy. And I think we will see probably some of that, maybe it will impact some volumes or delays in some orders. But the bottom line is you know the conflict in that region, you know the challenges they have from a global security standpoint. And because they have increased security responsibility since the US is not so prevalent there, they are having to step up and buy the things that we need -- that they need in order to protect their citizens. So we anticipate continued demand, it’s just a matter of maybe some things will slip. That’s not unusual in the international marketplace even on a good day. I mean we don't always see things come right online with what we anticipate anyway because as they are dealing with multiple procurements they may have to do it more serially sometimes and get one out of the way before they move on to the next. And so we have to wade through that process.

Operator

Our next question comes from Sam Pearlstein with Wells Fargo.

Sam Pearlstein

Can you talk a little bit about ULA? You had said you thought it would be flattish this year; it looks like it was down a little in the first quarter. And at least the press talked about a further headcount reduction this year and then again next year. So trying to just think about how severance would flow through. And then if I could follow up with a second one. Just in your proxy you removed the orders category from some of the incentive comp and just want to talk through why you would have made that change at this point?

Bruce Tanner

Yes, Sam, I will take the ULA question. So ULA was down in the first quarter in terms of the equity earnings. It’s purely timing, we actually expect ULA's earnings will be higher in 2016 than 2015. That’s actually -- the primary reason behind the guidance increase in Space Systems is in fact because we do have a higher expectation of ULA. The severance charges that were taken on ULA, I don't think you will see much impact of that in the numbers and that’s just a little bit of -- you have got the severance costs offset by the lower cost once the people are removed. And that will, I think at least in 2016, be somewhat neutral for the year. It’s a little too early for me to call 2017, but that is the expectation for 2016.

Orders in the proxy, we had a lot of discussion about that, Sam, and we actually had -- and Marillyn can comment on this as well obviously -- but we actually had a lot of discussions with the Board and our compensation committee. And the concern was that because orders are so variable, I mean a perfect example perhaps is you can imagine a scenario where we had won the bomber program in 2015, but it had been protested and pushed out in 2016. Do you give actually someone credit for having won it or do you say you missed it because you didn't bring it home? I mean these are some of the real-life conversations that we had. And we ultimately decided that sales, earnings and cash flow were better measures of the actual performance without the customer vagary going on there in terms of awards.

I'll remind you also that we do have an incentive compensation metric associated with the focus programs. And the thought was as long as we win the right programs, I mean whether or not -- I will make this up -- whether or not the fiscal year LRIP 12 on F-35 happens in December or January is probably not as important as winning some of our critical competitions. And so, we decided to sort of focus more on the critical competitions as opposed to some of the timing vagaries associated with orders that really don't influence the economics or financials of the company whether they happen again end of this year or beginning of next year.

Marillyn Hewson

Let me just add to that. I think Bruce has covered it well, but just -- if you look at how we have outlined our incentive compensation, we have very clearly on the financials sales orders and cash -- I mean sales even cash as you see. And then where the orders come into play is in the strategic and operational area. And that is still an element of compensation. We look at it more in terms of focus programs, as Bruce said, or programs that we need to continue on contract growth with and keep sold and keep them forward. But as we flow down those metrics throughout the organization, the individuals in the organization are still going to be tracking their orders, they are still going to be driving to achieve levels of financial performance on the orders front. So, it’s not something we have taken out, it’s just that we have looked at it more realistically on how we -- what we should be compensating for in terms of incentive compensation. And it’s still an element, it’s just not outlined as a digital requirement.

Operator

Our next question comes from George Shapiro with Shapiro Research.

George Shapiro

Bruce, I wanted to pursue on the F-35 margin, you said last year was 10% obviously including the one-time catch ups. Given that this year the profit was only up $30 million on $400 million sales increase, obviously that relates to having lower pickups. Could you tell us though what the F-35 margin actually was this year and maybe kind of what the run rate has been going at?

Bruce Tanner

Yes. So, George, it’s a little lower. I mean the reason I highlighted the first quarter of last year, that’s probably the high point of any quarter in the history of the F-35 program. And that’s to say that is what we expect eventually to become sort of standard practice is that will be a double-digit program going forward just as F-16s, F-22s, C-130s and you name the program are. First quarter of 2016 is a little less than 2015 but not much less. We still had good performance, and you should think of that as even though the step ups were lower, sort of the run rate of the program is higher. And therefore it’s almost comparable but not quite to what we performed in 2016 -- excuse me, in 2015 in the first quarter compared to 2016.

Run rate, as I said to the earlier question, I have lost track now who asked it. But our expectation is we still do expect to have margin improvement on the entire program, including the development contract. But the total F-35 program this year in total is probably 50 basis points margins higher than it was in 2015. So again, nice progression, not quite as high as the 100 basis points we talked last year but still progressing nicely and sort of in line with what I have said all along which is that double-digit by the time we get to full rate production.

Operator

Our next question comes from Seth Seifman with JPMorgan.

Seth Seifman

So on F-35, I think we all understand that there is a lot of good progress that has been made but that there is also still challenges ahead. So when you think about those challenges, which we read about fairly often, if the development portion of the program was to become extended, let's say, into 2018 in terms of financial implications, I am guessing they are fairly -- there is fairly little exposure to you. But are there concurrency implications to that? For example, if there are issues that delay the program further is the exposure for you sort of in going back into and making upgrades to aircraft? And could you talk about how much we should be concerned about that if at all?

Bruce Tanner

Yes, let me take a shot, that's a really good question, Seth. And let me just give you hopefully a thoughtful answer to your question there. So the challenges that we have on the development program are surely winding down as we are progressing through a lot of the changes. A lot of the -- I will say the impacts that might result -- your question sort of tallied what's going on with concurrency changes if in fact of the development program stretched out. Most of the structural types of testing that could result in I will say large concurrency changes, we should have a really, really good idea of where those are probably by the end of this year or in the middle of next year as we complete sort of the fatigue testing and the multiple useful life testing of all three variants.

We are -- I have lost track off the top of my head where we are in progressing on that, but all three variants are well past a single useful life in terms of their durability and we are in 150% of useful life and beyond I believe for where we are on the testing of that. So most of the structural items I would say, I wouldn't expect to see huge concurrency impacts. There may be some relative to some software changes that come out of it relative to some testing and particularly some of the armament testing later in the developmental program that might result in some software changes. I don't typically view those as sort of concurrency issues. We are still on track for the IOC of the USAF later this year. We are making really good progress on the software to accomplish that.

The Atlas program is probably the other thing that we all have our eyes on in terms of this is the sustainment vehicle that sort of is your one-stop shop for sustainment on the F-35 program. And the huge amount of software that we are doing there is high on our list of things to be mindful of. But I think that's still going to support the IOC and whatever that's scheduled the fourth quarter or so of this year. I remind you the development contract is still cost reimbursable. And I know your question was more on the concurrency. But we really do think most of the concurrency risk starts to fade pretty measurably once we get past these testings the latter part of this year and into early 2017.

Operator

Our next question comes from Myles Walton with Deutsche Bank.

Myles Walton

Bruce and Marillyn, I think you talked about top-line organic growth targets of the company going forward in the 3% to 5% range with the outside contributor at Aeronautics. But that's also where you did the headcount reduction actions. So two kind of subpart questions. One, is that growth rate still the right growth rate to think about? And two, is this more of a reactionary headcount to some of the ongoing negotiations as it relates to F-35 and/or other internal DOD competitive pressures?

Bruce Tanner

Let me try that to begin with. I will let Marillyn chime in, Myles. But so I think I have said publicly, once you sort of strip out IS&GS and you sort of re-baseline Lockheed Martin without IS&GS in the portfolio, I think organically going forward you should expect us to have about 3% to 5% growth heavily driven obviously by the F-35 program and Aeronautics in general. Also contributing to that is across all the business areas -- it may not be self evident because we've actually got some DOD contraction in some of the business areas there. But our international growth is probably going to grow from 21% or so this year to somewhere in the 25% in the not-too-distant future. So that's helping fuel that growth as well.

As far as the reductions, I would say that's not because of pressure that's being put on us from a DOD perspective. There is -- if you just think of sort of the lifecycle, it goes back a little bit to Seth's question there. The development program is winding down, the production program is going leaps and bounds year over year. And so, the workforce is sort of transitioning more from sort of an engineering dominant workforce to more of a manufacturing base workforce. And we are starting to see that transition occur. And that's what some of these reductions are for is simply the lower level of sort of the development program going down and the higher production program increasing without the same number of heads required to support the manufacturing growth as what we saw in the development programs, if that makes sense.

Marillyn Hewson

Yes, I would just -- I think you have got that right on the mark, Bruce. But to add to that, it's also changing the nature of the work that the indirect personnel support to that. And so you don't need the same number of people that are in certain roles as you move into the production phase and you ramp up that production.

Bruce Tanner

It may not be perfectly evident, Myles, but recall we did -- we, Lockheed Martin, did -- were responsible for the large bulk of the development program there. Whereas the production program obviously is a lot more of the supply chain including two large partners there. So, they are doing pretty good chunks of the aircraft from a production perspective whereas we were doing I will say more of the development program as pure Lockheed Martin.

Operator

Our next question comes from Howard Rubel with Jefferies.

Howard Rubel

Marillyn, there is -- not to kind of show off a little bit, but you didn't mention Pakistan and F-16s. And I suspect you probably have some other opportunities there. And then an addition to addressing that, would you also talk about a number of the items that are in the HASC mark that sure seem to play into your wheelhouse, whether it’s the F-22 restart or some new air defense system opportunities?

Marillyn Hewson

Thanks, Howard. Appreciate the question. And just from -- back to your question about F-16, I mean we continue to look for opportunities for F-16. Certainly Pakistan as it got through its congressional notification, we'll look forward to the opportunity on that. Bahrain, we hopefully ultimately at some point in the future will have an opportunity. In India we are continuing with our upgrades of the F-16, a lot of the modification work like in Taiwan, and so –

Bruce Tanner

And the potential line started in India.

Marillyn Hewson

That’s right. Yes, we talked about that India is looking at their tactical fighter competition and we are in there with an offer to move a production line to India.

In terms of the mark, the most recent mark that came out of the HASC for the defense bill, they have -- as you have seen, have added 11 aircraft for the F-35. And so we saw an increase last year in the FY16 Omnibus. And so, seeing that coming forward is important. There are also -- a lot of our programs are well supported just in the budget itself. And then with potential adds as they look at additional opportunities.

On the F-22, I know there has been some discussion about a restart on the F-22 and we just stand ready to support with whatever information we are asked to provide. You are probably aware that the tooling [ph] does still exist, and so there will be -- as most programs, if you start one from a cold start I am sure that they really want to understand the cost associated with a cold start. But at the same time you wouldn't want to build the same aircraft, so you will do some upgrades to that aircraft, modernize it and some of the design -- incorporate some of the things that we have learned through F-35 and other programs that you can incorporate into that. So we will stand ready to support that.

But the bottom line is I think our programs are well supported in the President's budget submission. And then I think the market is going through -- would potentially add some additional ones for us. And we know there is a long way to go on the budget process; it’s early days in getting through that. So we will remain hopeful that with our programs that are -- they really line up with the Department's strategic priorities that they will continue to be well supported.

Operator

Our next question comes from Pete Skibitski with Drexel Hamilton.

Pete Skibitski

Yes, thanks, nice quarter, guys. I appreciate the color on Sikorsky earlier. I was just wondering if you could go farther and update us on your expectations for -- your updated expectations for intangibles amortization this year and integration costs. And how fast or what magnitude you expect that to kind of drop off in ‘17 and ‘18?

Bruce Tanner

Yes, thanks, Pete. I will take that on. So intangibles, we had said in the January call that those might move around. I think we have a year's time to sort of set the numbers there. I think we are real, real close. It’s a slight improvement in the intangible amortization. When I say slight improvement, it's a little bit slower or smaller intangible amortization in 2016 than we had originally talked about, but not enough to get too excited about to be honest with you.

The integration cost, I still think that the bulk of that will be completed in 2017. And still some of that might carry over into 2018 -- excuse me, 2017 as we look forward there. I still think as we sit here today that we are tracking towards what we talked about when we did the acquisition, which was about $150 million or so per year of steady-state savings beginning in 2018. I still think that’s a good possibility that that will be the number that we are seeing then. We have got a lot of work to do between now and then. And as I said earlier, I think we're actually tracking very nicely to what our expectations were on Sikorsky.

Jerry Kircher

Abigail, this is Jerry. I think we will have time for one more question.

Operator

Our last question comes from the line of Cai von Rumohr with Cowen.

Cai von Rumohr

So, if we can go back to the severance charge, Bruce, $99 million -- can you give us some color, how does that split between Aero and IS&G? What sort of folks did you lay off? Do you expect to recover all of it this year? And if so, how come the guide for Aero and IS&G didn't go up by more than $25 million each?

Bruce Tanner

Yes so, I think the way you should think about the severance charge, Cai, is somewhere in the range of roughly three quarters is Aero, somewhere in the $70-ish million and the difference -- $70 million to $75 million maybe and the difference is in IS&GS. I don't have the numbers exactly to memory, Cai, but somewhere in that range -- three quarters/one quarter or so.

As I said earlier, and I think I was talking to Myles on the question on the headcount reductions at Aeronautics. Most of these are salaried folks. As Marillyn said, some of the indirect support required to – it's no longer going to be required to support sort of the production ramp rate that was required to support some of the developmental work that we were doing. Importantly, I think a big piece of the Aeronautics reduction was actually a voluntary reduction. And I think we actually got about what we were expecting as a result of that voluntary reduction. So we were pleased with that that people -- that it came with very few, I will say, involuntary reductions. So I think that's a good thing as well.

And then as far as the recovery of this year or not, that's still playing out, Cai. We are trying -- I mean I think in big picture terms you should expect to see a somewhat neutral reaction in 2016. And there may be some benefit depending on what the timing is of the reductions or the severance charges as they play out that may carry into 2017. We will watch that closely and monitor that as we go through the next three quarters to see if there is an impact in 2016. But if -- and if there is we will surely tell you about it. And if it happens in 2017 we will try to give you insight into that quickly as well.

End of Q&A

Marillyn Hewson

So let me conclude the call for today and I just want to end by reiterating that the Corporation completed a very strong first quarter. Our robust backlog coupled with an increasing DOD budget has the Corporation positioned for top-line growth and increasing cash flows into the future. So, thank you again for joining us on the call today. We look forward to speaking with you on our next earnings call in July. Abigail, that concludes the call today.