Ladies and gentlemen, thank you for standing by, and welcome to the Lockheed Martin Fourth Quarter and Full Year 2018 Earnings Conference Call. [Operator Instructions] As a reminder, today's call is being recorded.

I'll turn the conference now to Mr. Greg Gardner, Vice President of Investor Relations. Please go ahead, sir.

Greg Gardner

Thank you, John, and good morning. I'd like to welcome everyone to our fourth quarter 2018 earnings conference call. Joining me today on the call are Marillyn Hewson, our Chairman, President and Chief Executive Officer; Bruce Tanner, our Executive Vice President and Chief Financial Officer; and Ken Possenriede, our Executive Vice President and Chief Financial Officer Elect.

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

We have posted charts on our website today that we 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 would like to turn the call over to Marillyn.

Marillyn Hewson

Good morning, everyone, and thank you for joining us today on our fourth quarter 2018 earnings call. I hope everyone has had a good start to the New Year.

As you heard Greg mention, we are joined today by Ken Possenriede, our CFO Elect, who will take over for Bruce after we file our 10-K in February, as Bruce has announced that he is retiring later this year. Ken and I worked together quite a bit over the years and I'm very excited that he will join our Executive Leadership Team as CFO. I'll have a few more thoughts to add about both Bruce and Ken after our Q&A portion of the call. But for now, welcome Ken.

Kenneth Possenriede

Thank you, Marillyn.

Marillyn Hewson

I'll begin by thanking our entire Lockheed Martin team for an impressive year and express my gratitude for their outstanding contribution throughout 2018. It was through their dedication and commitment that we were able to deliver results, which not only exceeded many of our expectations but also set records across a number of our financial metrics.

Notably, all four of our business areas grew sales, earnings and backlog during the year. Our strong performance was broad-based and a reflection of the continuing demand for our wide range of products.

I'll touch on some of the performance highlights in just a moment, including some important F-35 international activities, but I want to first discuss a few of the notable new business successes that contributed to our fourth quarter orders and showed the strength of our broad portfolio.

Aeronautics received the largest single order of the quarter and the year with the announcement of our F-35 production lots 12, 13 and 14 economic order quantity, or EOQ, award at an incremental value of approximately $19 billion, adding over 250 aircrafts to our backlog.

Our F-35 aircraft backlog has grown to nearly 400 planes, a level which exceeds the total of 35 deliveries we've made to-date, a clear sign of the program's momentum. We continue to work with the F-35 joint program office to finalize the full order of lots 12, 13 and 14, which once completed will represent a total of 478 aircraft.

International community expressed their continued interest in our legacy F-16 fighter program for both upgrades and new production units of our Viper Aircraft configuration. Our aero team closed on an opportunity with Greece to modernize 85 of their current F-16 fleet to this advanced platform, continuing the partnership with the Greek military that has spanned more than 70 years.

The Bulgarian Ministry of Defense announced their intent to procure eight new jets. Once the contract is finalized and definitized, Bulgaria will join Bahrain and Slovakia as new F-16 customers, extending our backlog of Fighting Falcons well into the mid-2020s.

Our Missiles and Fire Control team secured a PAC-3 Award to deliver over 450 interceptors, launcher modification kits and associated equipment to the U.S. Army and foreign military sales customers.

To-date, 13 nations have chosen PAC-3 products to provide missile defense capabilities for their citizens and we continue to expand our manufacturing facilities to satisfy the growing requirement.

Also this quarter, Rotary and Mission Systems won a competitive award from the Missile Defense Agency to design and develop a second homeland defense radar system and provide installation services for our solution in Hawaii.

This $585 million contract is part of the U.S. Military's ballistic missile defense system and will provide improved tracking and discrimination technologies to counter evolving ballistic missile threats.

This strategic win leverages capabilities developed on our long-range discrimination radar contract and provides the lowest risk solution to identify and warn of long-range ballistic missile threats during mid-course flight.

These announcements reflect the strength of our legacy programs as well as our commitment to innovation that has resulted in new strategic long-term growth opportunities. I'm very proud of our Lockheed Martin team and the passions with which we pursue new business solution to support our customers' missions.

Moving briefly to the federal budget environment, the Department of Defense is operating under the 2019 fiscal year Appropriations Act that became law last year. The Appropriations Act fully funded the Defense Department, providing approximately $617 billion of base budget funding for the nation's security and defense programs.

The legislation aligned with the Bipartisan Budget Act of 2018, which provided additional funding for national defense and raises the budget caps for fiscal 2019. We will wait the release of the FY20 Presidential Budget submission in the coming weeks. We believe it will align with the National Defense strategy's focus on missile defense, nuclear, space, cyber, joint lethality and intelligence capabilities. We anticipate that the budget input will reflect these priorities and we believe our portfolio is well aligned with this strategy.

We are hopeful that fiscal year 2020 funding will be in line with, or better than, prior Presidential Budget request and that it will continue to emphasize recapitalization of our nation's defense assets and the research and development that is critical to maintain our country's future security.

Several days ago, an agreement was reached to temporarily open, through February 15th, the federal agencies that were affected by the recent partial shutdown of the government. The previous closure of these agencies did not have a significant impact on this year's anticipated financial metrics, as a vast majority of our business is currently funded through the DOD's FY19 Appropriations Bill. Should the budget impasse recur after the three-week continuing resolution expires, it is possible we could see some delays in 2019 Awards and Orders.

As government leaders negotiate a new spending agreement, we continue to advocate for stable and consistent budgeting that enables U.S. government agencies and the industry to plan, invest and execute with confidence.

Moving on, I'd like to highlight several significant events that occurred across the corporation during the past quarter. Beginning with an update on our F-35 program, we saw several accomplishments and important milestones take place this quarter that spotlight the program's mature production and base deployment activities, as well as the continuing demand we see from the international community.

First, we delivered our 91st F-35 aircraft of the year on December 20th, meeting our 2018 target and exceeding our 2017 deliveries by 25 jets, an increase of nearly 40%. Notably, of the 91 airplanes delivered last year, 37 were for international partners and foreign military sales customers, evidence of the growing global interest in this fifth-generation fighter.

In October, we were very pleased to learn that the Belgian Ministry of Defense selected the F-35 aircraft for its future fighter acquisition program. With this selection, Belgium becomes the 13th nation to join the F-35 program of record with the plan to buy of 34 conventional takeoff and landing or CTOL models.

Lockheed Martin is honored by the Belgian government's selection of the F-35 for their future national security needs, building on our long-running strategic partnership with the Belgian Air Force and their legacy fleet of F-16 Fighting Falcons. We look forward to continuing this relationship and helping to provide long-term capability for the Belgian Military.

In addition, Japan's National Security Council and Cabinet signaled continued support for the F-35, authorizing acquisition of 105 additional jets, adding to the 42 aircraft already approved. The Japanese F-35 plan includes, for the first time, acquisition of 42 short takeoff and vertical landing or STOVL variants. And the 147 total aircraft procurement will make Japan the largest international customer for this unrivaled fifth-generation fighter.

And just a week ago, the Republic of Singapore's Defense Minister announced the selection of F-35 as the aircraft most suitable to be their country's next-generation fighter. Singapore will initiate the process to procure a small number of jets to fully evaluate the capabilities of the plane, after which we will follow a decision as to the best approach to replace their legacy F-16 fleet. We are honored to be selected at this time and look forward to supporting the Republic of Singapore Air Force during this process.

Some of our original F-35 partners also celebrated key milestones this quarter. Australia welcomed the arrival of its first two F-35 conventional takeoff and landing aircraft at Royal Australian Air Force Base, Williamtown, the site of Australia's first operational squadron. Australia becomes the seventh nation with F-35 aircraft based on their home soil, ushering in a new era for their nation's defensive capabilities.

And both Italy and the United Kingdom have now declared their respective fleets of F-35 combat-ready with the Italian Air Force declaring initial operational capability for their squadron of CTOL variants in late-November and the UK declaring IOC for their STOVL variants earlier this month.

With these announcements, we have now seen four countries declaring F-35-ready for frontline operations, demonstrating the maturity and momentum of the Joint Strike Fighter program.

In Missiles and Fire Control, our tactical and strike missile team delivered their first long-range anti-ship missiles called LRASM, precision-guided missile to U.S. operational units, thereby achieving early operational capability status ahead of the programs scheduled.

This milestone follows an intense integration and test phase, which culminated in the airlines for LRASM variant successfully completing multiple tests from the U.S. Air Force B-1 Lancer Bomber, demonstrating our ability to rapidly deliver crucial capabilities to our war fighters. The LRASM program represents a long-term strategic opportunity and we are excited to have begun the journey with our first delivery.

In our Rotary and Mission Systems business area, we were very pleased to be selected by the Royal Canadian Navy as a member of Canada's combat ship team to be their preferred bidder to begin design work for the future fleet of Canadian Service Combatant ships. Lockheed Martin Canada will be the combat systems integrator and provide the combat management system we originally developed for the Royal Canadian Navy's Halifax-class ships, providing important technology to help deliver a bow-to-stern, digitally-designed warship.

A total of 15 ships are planned to be built to replace Canada's Iroquois-class destroyer and Halifax-class frigates and will form the backbone of Canada's maritime combat power for decades to come. The Canadian Service Combatant Program is the largest defense project ever undertaken by the government of Canada. And when completed, the RMS team could see orders totaling approximately $7 billion for their role in this effort.

I'll close with our Space business area and a truly historic event. The NASA InSight Mars Lander designed and built by Lockheed Martin's Space engineers, made a dramatic entry and descend through the Martian atmosphere and successfully touched down on the surface of the red planet.

Over the course of 6.5 minutes, the InSight Lander went from a speed of 12,300 miles per hour to a gentle landing in the Equatorial region of Mars. The robotic explorer has now begun its task of studying the interior of the planet; its crust, mantle and core with a goal of better understanding the geologic evolution of Mars, as well as other terrestrial planets.

The InSight Mars Lander is the latest in the long Lockheed Martin heritage of participating in NASA and Mars programs dating back to 1976 in the Viking mission, and we are honored to have played a significant role in this and all 10 preceding NASA missions to Mars.

With that, I'll turn the call over to Bruce.

Bruce Tanner

Thanks Marillyn; and good morning, everyone.

As I highlight our key financial accomplishments, please follow along with the web charts that we included with our earnings release today. Let's begin with Chart 3 and an overview of our results for the year. Both our sales and segment operating profit continued to exceed our expectations, as we close out the year.

Sales were $53.8 billion for the year, while segment operating profit was nearly $5.9 billion, about $800 million and $100 million higher, respectively, than when we spoke in October and this helped drive earnings per share to $17.59, also above over last outlook.

We generated $3.1 billion in cash from operations, after contributing $5 billion in pension contributions. Operating cash flow was slightly below our expectation, as a number of invoices were not paid until the beginning of 2019, taking longer to pay than our history would've led us to expect.

As a result of this carryover and continued strong cash performance, we have increased our cash guidance for 2019 above the outlook we provided in October and will discuss this in more detail in later charts.

We've returned $3.8 billion of cash to our stockholders, $2.3 billion in dividends and $1.5 billion in share repurchases. Our repurchase amount was higher than planned for the year, as we opportunistically increased our buybacks in the fourth quarter as overall equity markets declined, so we could capitalize on the reduced share price of Lockheed Martin as we closed out the year.

And, finally, but perhaps most importantly, we achieved a record level for backlog at year-end, finishing at over $130 billion. So we had a very strong finish to the year and we're well positioned to carry that momentum into 2019.

Turning to Chart 4, we compare our sales and segment operating profit in 2018 with our performance in 2017. Sales grew 8% for the year, while segment operating profit grew by 15% for the year, both finishing at record levels and all four business areas grew in both metrics as we'll show in the next couple of charts.

On Chart 5, we show the sales growth for the year by business area. Missiles and Fire Control had the strongest growth in 2018 at 16%, driven by continued tactical and strike missile growth along with increases in the Air Missile Defense portfolio.

Aeronautics grew by 9% for the year with F-35 providing most of that growth, while the Skunk Works and F-16 program also contributed to the increase, more than offsetting reductions in the C-5 program as we completed the RERP program in 2018.

Both RMS and Space had low single-digit increases in sales for the year with the RMS growth driven by the integrated warfare systems and sensors line of business, while the Space growth came from a strategic and missile defense line of business.

On Chart 6, we compare segment operating profit by business area in 2018 versus our results in 2017. Here, RMS had the largest increase in operating profit, 44% higher than last year. This increase was due to improved performance across the Sikorsky portfolio, as well as the absence of a charge taken last year on the EADGE-T program.

Missiles and Fire Control grew operating profit by 21%, due to improved performance in tactical and strike missiles and a number of sensor programs. Space increased operating profit by 8%, due to improved performance in both the commercial and government satellite lines of business, and Aero grew its operating profit by low-single digits due to higher volume and improves performance on both F-35 production and sustainment contracts.

If you'll turn to Chart 7, we'll discuss the significant increase in earnings per share this year compared with last year. We ended the year with EPS of $17.59, an increase of roughly 33% over our 2017 EPS after adding back $6.77 worth of net tax reform changes that negatively impacted last year's results.

Our results for the year included a negative impact of a non-cash impairment and the international joint venture investment that reduced EPS by $0.29. The overall increase this year was driven by higher segment operating profit and a lower effective tax rate.

Chart 8 shows the increase in backlog over last year's amount to a - the record level of $130 billion. Backlog grew nearly 25%, driven by a book-to-bill ratio of 1.5 for the year with Aeronautics setting the larger increase but all four business areas grew backlog in the year.

Chart 9 provides our outlook for the expected performance and key financial metrics in 2019. Our sales guidance of $55.75 billion to $57.25 billion is higher at the midpoint than the high-end of the range we provided during the October call and implies 5% growth over our 2018 results. Segment operating profit at the midpoint also implies a margin at the high-end of the range that we gave in October.

Our net FAS/CAS pension adjustment of $1.475 billion is $25 million lower than we estimated last quarter and we'll discuss the drivers of the change in a couple of charts.

Our EPS from continuing operations is expected to be in the $19.15 to $19.45 range, nearly 10% higher than our results in 2018. And we expect cash from operations will be equal to or greater than $7.4 billion, recognizing both the invoices that carried over into 2019 from 2018 and an improved outlook from the business areas for the year.

Chart 10 shows the expected business area ranges for both sales and segment operating profit for the year. Missiles and Fire Control is again expected to be our fastest growing business area with around 10% growth over 2018, while Aeronautics is expected to grow in the high single-digit level. RMS and Space are both expected to have slight increases over their 2018 results.

Margins for the business areas are roughly comparable to our performance in 2018 except for Space, which has impacted this year by lower equity earnings at ULA as we discussed on the last call.

On Chart 11, we provide a comparison of our net FAS/CAS adjustment and our current outlook compared with the preliminary review we provided in

October. The return on plan assets during 2018 was negative 5% versus a positive 1% return when we spoke in October, reflecting the large reductions in equity returns that occurred between October and the end of the year and this change in our return lowered the adjustment by $120 million.

The discount rate used to value our liabilities increased slightly to 4.25% and this results in a $60 million improvement. Other actuarial updates to the plan, primarily a revised longevity expectation contributed to a $35 million of improvement. All told, these updates lower the FAS/CAS adjustment by $25 million to our new expectation of $1.475 billion.

And, finally, at the bottom of the chart, we mentioned two pension risk mitigation transactions that we completed in December, but have no significant impact on either our financial results in 2018 or our projections for 2019 and we'll describe these transactions in more detail on the next chart.

Chart 12 summarizes the two pension transactions that occurred in December. These transactions are transferring the responsibility for pension obligation for around 41,000 or a little more than 25% of our current retirees to two insurers. There is no change in the timing or amount of pension payments to our retirees, but with the transfer we've eliminated all volatility associated with $2.5 billion of current pension obligations.

We had favorable pricing on the transfer and we immediately see a $25 million per year reduction in our PBGC premiums going forward, and we have the option to settle around $800 million of planned liabilities with the U.S. government at a future date, which would accelerate CAS prepayments into the year of settlement, increasing our cash from operations in that year by the amount of the CAS acceleration.

So we think this creates a win-win situation, providing the same benefits to retirees going forward, while reducing future volatility for the business and our customers.

And, finally, on Chart 13, we have our summary. 2018 was an outstanding year for both operational and financial performance. We're very pleased with the record backlog that we achieved last year and that all four business areas contributed to that record level. And we're very excited to continue to deliver growth and long-term value creation in 2019 and beyond.

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

Question-and-Answer Session

Operator

[Operator Instructions] And first from the line of Noah Poponak with Goldman Sachs. Please go ahead.

Noah Poponak

Bruce, many congrats to you. It was great working with you; and Ken, welcome on-board.

Bruce Tanner

Thanks, Noah.

Kenneth Possenriede

Thank you.

Noah Poponak

Bruce, so with the cash flow guidance for 2019, it looks like it’s maybe slightly better operationally than you thought before and then you had the slippage out of 2018. So, one, is that true that it's a little better operationally? And then two, I guess for - year-over-year into 2020, you previously had a placeholder of something in the zone of flat, can you still be flat to slightly up in 2020 even with the working capital lift that I guess is specific to 2019?

And then may be update us, I think you'd previously said, on '21 when the pension contribution comes back online that you saw enough working capital opportunity to offset that and grow cash flow again. Is that still the case?

Bruce Tanner

Yes. So let me dive into that, I think it's a three- parter there, Noah.

Noah Poponak

Got to get it in before you go.

Bruce Tanner

Very good of you. So yes, we are operationally seeing improved cash from operations in 2019. Part of that is simply because we are having higher profit from the business areas and in the form of segment operating profit and we would expect to recover some of that in terms of cash in 2019. So it's a combination just as you described it.

The carryover in invoices, call it, $250 million or so plus some improvement in operations from the business areas making up the difference to get to $400 million.

You asked about 2020 flat to up. I'd say we are still seeing the outlook for probably both 2020 and 2021 in the 7 - at least $7 billion or greater range. We've had a little bit of pressure as you might expect, because of the lower performance of our pension plan.

So just like everyone else from October to December, as I described in my prepared remarks, the pension trust went for a slightly positive return to a 5% negative. But if you take a look at the total change and expectations of assets to asset return to where we ended up, that's a pretty big miss.

And so, we'll have some continued higher ERISA payments that start to kick in about the 2020 timeframe, higher than what we talked about in the last call and higher still than what we talked about, I think, on the last call in 2021. Even with those higher ERISA contributions to sort of refill the pension trust for the asset performance last year, we still expect to achieve another $7 billion-plus in each of those payments - in each of those years, excuse me, going forward.

And that is a reflection, Noah, to your question of improved performance and working capital as well as the higher segment operating profit and return of cash resulting from that in the next couple of years.

Operator

Our next question is from Sheila Kahyaoglu with Jefferies. Please go ahead.

Sheila Kahyaoglu

Just on the F-35, there's clear signs that it's growing and there is continued growth in the program. How do we, maybe, think about the cadence of that 400 aircraft conversion and maybe the profit curve on that program given international and as the block buy versus the multiyear?

Bruce Tanner

Everyone is going to do three-parters this time, ah?

Sheila Kahyaoglu

One topic, three parts.

Bruce Tanner

So, yeah, F-35's got a real good cadence. I thought it was really interesting to listen to Marillyn talk about the fact that we got more aircraft at the end of the year in terms of backlog than we've delivered since the inception of the program. That's a - just thinking about that, that's a big number.

And that reflected for the block buy getting, call it, 250 aircrafts worth of - sort of advance payment and that was the large award that we booked in the fourth quarter. But it's only, what, 250 out of what we expect LRIP 12, 13 and 14 to be which is closer to about 400 - call it, 475 to 480 aircrafts.

So we would expect over time to get those higher quantities of aircraft and you'll see that reflect in the backlog going forward. You will also see, Sheila, growth in our expected deliveries going forward from 91 this year to about 131, I said 91 this year, 91 in 2018 to about 131 next year. And that number will grow slightly higher in 2020 and slightly higher still in 2021, at least that's the expectation until we actually get north of 160 deliveries in 2021, so good continuing ramp up there.

You asked about margins, we see - we had good performance in 2018 and we expect to see especially on the production program some continued good performance. I would expect margins to maybe increase 50-plus basis points over what we saw in 2018 as we sort of get to a more steady-state of what we expect to have as we've talked about for quite some time of margin similar to our experience on other production programs in our portfolios, including F-16, F-22 and C-130s and the like.

And the only thing I might offer up, Sheila, is, we're seeing production growth as I talked about with the quantities of aircraft, but we're also seeing some pretty significant sustainment growth and I think I have said this on the last call, somewhat surprisingly, actually on a percentage basis the fastest growing part of the F-35 program is actually the development program. And that's because we're starting to get modifications of the aircrafts, some international peculiar updates for improvements going forward. So that's actually growing as well.

And as I think I said on prior calls, well, that's typically cost reimbursable and therefore lower margin overall than the program, that still good work that leads to future production and/or sustainment work going forward. So program is in a very good position right now and on a strong cadence as we end 2018 and going into 2019.

Operator

Our next question is from Jon Raviv with Citi. Please go ahead.

Jon Raviv

Bruce, can you touch a little bit on the - just on the - kind of related to Noah’s question in terms of cash sustainability, obviously cash recovery is a big piece of that operating cash flow, that $7 billion, just given that what you know has happened in 2018? Now, any update on the shape of that cash number going forward? How long [is it with us] [ph] till it roll off there? Thank you.

Bruce Tanner

So we've talked about in the past that whenever there is a change in expectations relative to our performance and we're more sensitive, I think I've said that in the past as we sit here today, on asset returns than we are on discount rates with our pension financials going forward. So because we were short of our expectations in 2018, you will see a slight increase in the near-term of CAS to essentially recoup that shortage in our expectations over time.

Unfortunately, ERISA requires an earlier contribution than I even - even after we've had CAS [normalization] [ph], we should still think of CAS recovery on our contract takes longer to occur than the ERISA contributions, and that's the comment that I was making earlier to Noah about a little bit of higher ERISA contributions in the near-term.

But to your question, Jon, CAS will - I think in 2018, we're about 2.4, call it, a little more than that billion dollars. I would think CAS at the new levels based on our performance in 2018 will probably stay at the, call it, 2.5, I think we're a little higher than that level of CAS reimbursements in 2019. And then it sort of stays that way in '20, '21, '22 and then current course and speed if we continue to get 7% returns on the assets going forward, we would expect to see a significant reduction in CAS costing and CAS recoveries from '22 to, call it, 2026 and beyond to a very, very steep down slope in terms of CAS reductions there.

So sort of not much change in the next three, four years and then if we continue on the current course and speed or we do better on asset returns going forward, then we would expect to see a pretty good size reduction in that. You would also expect to see at a quicker pace a reduction in the ERISA contributions, because ERISA is spread over shorter period of time to sort of recoup the asset return miss we had in 2018 than is the CAS spread, if you will. So CAS is spread longer to recoup that. Hope that helps, Jon.

Operator

And our next question is from Ron Epstein with Bank of America Merrill Lynch. Please go ahead.

Ron Epstein

When you look at the backlog build, right, I guess a lot of that had to do with F-35 and the year-end backlog was, I think, probably a little bit above what you guys were thinking in Q3, right. And then I look at the guidance for the year, I mean how much conservatism is built in there? Because it just looks like with that kind of backlog build that revenue growth this year might be a little bit better. I don't know I'm just kind of throwing that one out there?

Bruce Tanner

Well, I guess if I was smart I'd set Ken up for a bigger number than a lower number, but I think we've got opportunities varying and we talk about Missiles and Fire Control growing 10%. We talked about Aeronautics growing at the high single-digit. Space and RMS, a very slight growth. If there's one business area I think that might have some potential revenue upside, I would say, it's probably RMS.

We sort of went into the year last year expecting RMS to be a little flattish, maybe a little bit of growth and I think we ended up at 4% or so growth for the year. So we beat that pretty well. I think there's a similar potential here.

We've got - I'll tell you, we've got a lot of new start programs. I mean, I was looking for list, getting ready for the call, it's just staggering, how many small literal new start pattern, that could translate into large patterns across all four business areas, so one of the sound bites I like more than anything is that while backlog grew for the corporation to a record level backlog grew for each of the four business areas. So this is very broad-based and very strong.

Again, not so much in huge big bite-sized chunks but a lot of smaller patterns is really what's driving that. And so, to your question, Ron, I think we have some potential upside, but I don't-we didn't purposely try to be ultraconservative in the revenue guidance. I think that's why we provide the range and that's why the upside is potentially at the top of the range.

I should have said, maybe they'll just a piggyback, I didn't answer I think Sheila's last question on the multiyear and that may be part of what you're asking about as well. But we would expect to see a multiyear agreement on the F-35 program probably sometime in the 2022 timeframe, so while we may see some slight backlog deterioration this year, it's hard to replicate the large block buy order that we saw in 2018.

We still expect to be probably north of $125 billion of backlog as we end the year and then that has the potential to grow from that level as we get into 2022 with the benefit of an F-35 block - excuse me, multiyear.

Operator

Our next question is from Rob Stallard with Vertical Research. Please go ahead.

Rob Stallard

Bruce, I will spare you a pension question and just wish you the best for your retirement.

Bruce Tanner

You break my heart with that pension question, Rob.

Rob Stallard

But Marilyn I have one for you. On the F-35 front, there's been various press reports that the DOD could be flirting with an F-16 order and comments from the Acting Secretary of Defense today seems to imply that there could be some pressure perhaps ahead for you on pricing for the F-35. I was wondering if you could give us your thoughts on that?

Marillyn Hewson

I would be happy to, Rob. In terms of the F-35, as we've outlined clearly, I mean it's well supported across the board regardless of what other platforms, the Department of Defense was looking at. So if they chose to have an order on F-15, I don't - it won't be at the expensive of F-35 quantities. I mean, I'm hearing that directly from leadership in the Pentagon and I think that's an important point to make, not just our suspicion, but I've been told that directly. So, I'm not concerned about that.

In terms of the pressure on the unit cost, we continue to have focus collectively with the Joint Program Office and with the Department of Defense on driving the price of the F-35 down and seeing the cost. We are on a path to drive it to an $80 million for the F-35A by full rate production when we're looking at 2023 deliveries of that aircraft and when we get to about 15 deliveries.

So that's - as long as we stay on our procurement rate plan, which by all accounts we're going to continue to ramp up the rate that we envisioned and we're going to continue to drive the price down and that's our target as to continue drive the unit cost down. And we won't stop there, we will always be looking at ways that we can take the cost down in the program as it continues to mature and grows.

Moreover, the total life cycle cost of the aircraft is coming down. We're working on the sustainment element, which is always something that our customers are interested in, not just purchase price but what does it cost to sustain the aircraft as its operational and those costs are coming down at a good pace as well.

Operator

Next we'll go to Myles Walton with UBS. Please go ahead.

Myles Walton

One clarification and then one question, so Bruce you mentioned the headwind on ULA, I'm just curious if it's still $150 million? And the question, maybe for Marilyn, you're seeing the start of some of the first incremental customers coming to the F-35 in quite some time. Do you think there is actually pressure to the upside from these 160 per year, probably planning rates that you've had for a number of years. I know you have gotten request for something higher than that, but at what point do you think there's reality behind some of those requests for pricing for upward of 180 per year pricing?

Bruce Tanner

Well, I'll take the first part. You've got a good memory, Myles. We did talk, I think on the October call about as much as $150 million pressure from ULA year-over-year from 2018 to 2019. I think you should think of that closer to maybe like $100 million now. And part of that is, we did get a little better outlook from ULA, but that's part of it.

But the bigger piece quite honestly was, we actually had a launch vehicle that we had expected to deliver in the latter part of December, that for weather purposes and some other purposes, actually slipped into 2019. In fact, you might have seen - that was the first launch of the year. It was actually an event that was supposed to have occurred last year.

So think of that launch carrying on for and the profits associated with that launch vehicle also carrying over, which made that $150 million along with the improved performance expectation at ULA cause a number to, like I said, probably be about a $100 million short of last year's ULA equity earnings amount.

And I'll turn it over to Marillyn for the F-35 question.

Marillyn Hewson

Yes, Myles, to your question about the growth in the international demand for the program, we are certainly seeing with a highlight of few near-term things, but F-35 is in the competitions in Switzerland and Finland and Germany and whole range of countries that continue to look at it. So we expect to continue to see growth in the international demand.

Your question around, can we increase the rate accordingly or so forth. I mean, it's really too early to be too specific on that, but over time if we could see that we could exceed the current program of record on the F-35 and that would open up the opportunity for us to produce more per year. And we have the manufacturing capacity for over 180 aircraft per year.

We'll still have to coordinate with the JPO, the Joint Program Office, we'll still have to work with our supply chain and our international customers to really get the most effective plan possible. But we could certainly go to a higher rate if the demand were such that we needed to do that. So that's a good problem to have and we look forward to that.

Myles Walton

And Japan?

Marillyn Hewson

And also Japan, yes, I mentioned Japan already in my formal remarks about the increase there as they have already committed to 105 aircraft and we expect some of the existing customers to continue to increase their demand for the aircraft as well.

Operator

Our next question is from Cai von Rumohr with Cowen & Company. Please go ahead.

Cai von Rumohr

Yes. Bruce, let me join the others and say you've done absolutely terrific, and best of wishes in your retirement.

Bruce Tanner

Thanks, Cai.

Cai von Rumohr

So in line with the two-part question, book-to-bill, if you could comment a little bit by the outlook for the year in the sectors? And secondly, you said, as I understood it, that the F-35 had may be 50 bps of margin upside. I thought that was in 2019. And if so, where is the downside? Because your aggregate guide shows Aeronautical margins relatively stable - may be up 10 bps?

Bruce Tanner

Yes. So let me - I'll try to address both of those for you, Cai. So book-to-bill, the 15, although there was obviously the 2018 results. The outlook for 2019, which I think is the heart of your question, we expect to have less orders in 2019 as you might expect, since we're not going to replicate the block buy order for F-35.

But as I said in response to a previous question, I think backlog - if we had a little more than $130 billion now, I think we dropped, call it, $4 million or $5 million to maybe a $125 billion plus. So we still expect to have a strong orders year in 2019. I think just for planning purposes, the things that you should watch out for is we are hopeful to get pretty large THAAD order for both combined by from the Kingdom of Saudi Arabia as well as MDA or ultimately to the U.S. Army in the first quarter.

As it turns out a little bit unusual compared to our pattern maybe in prior years, the second quarter is expected to be our largest order quarter and that's in part because we'll start - or at least we expect to start to definitize the LRIP 12, 13 and 14 that was authorized by the block buy. This would be just for the LRIP 12 portion and that definitization is a fairly good-sized number, call it north of $5 billion is the item there as well as some other orders we expect there.

For instance, we expect to get an order for two Orion vehicles in the second quarter as well. And may be somewhat surprisingly just given the size compared to years previously, they got a multiple launch rocket system, 14, as we're calling it is about $1 billion order that we're looking to see potentially in the second quarter.

So a little different phasing, as I said, for the orders in 2019 still strong, quite honestly not a whole lot of competitive awards there, most of them are sort of soul-source follow-on awards and without the benefit, as I said, earlier the block buy behind us or the potential for multiyear on F-35 in front of us. So, hopefully, that help sort of the orders in our expectation.

F-35, the 50 basis points that I was talking about is my expectation of improvement on the F-35 program for the 2019 margins compared to 2018 margins, a lot of that coming on the production program as we really are starting to kind of hit, as I said earlier, sort of cadence there. And why that's offset is part of what I said earlier, Cai.

I mean, literally there is - I think I'm literally writing down 15, 16 programs. They're all smaller than the large programs that I'm talking about that have the margin increases, but we have got classified activity in three of the four business areas that starting to get some traction. Aeronautics is one of those where we have that. We've got Hypersonics work in Aeronautics.

So a lot of, sort of, new start programs, including as I said earlier we're having growth in the sustainment and the development program on the F-35 program actually at a faster rate than the production rate is. And that's great news, but it does come with a slightly lower margins or the combination of all the new starts faster growing on some of the legacy stuff within the F-35 programs with lower margin, that's the reason why you don't see the overall Aeronautics margin growing from its - sort if it's level.

We're frankly happy with that, because that says we're sort of growing margin in the programs that you think should be growing margins, but we're getting the benefit of new programs - new start programs that have the potential to be the long-term growth engines of the corporation and, of course, those come with lower margins.

Operator

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

Pete Skibitski

Marillyn, maybe a question about politics in D.C. I feel like a lot of people are thinking that getting this last two-year resolution to the sequester might be maybe the most difficult compared to - than we've had so far. Would you agree with that? Is it going to be a challenge just kind of given where the parties are at or I know recently some of the - both parties that are directly involved on the defense committee seem to be a little bit more optimistic, but where do you kind of come down there? And how do you're thinking about timing on that?

Marillyn Hewson

Yes, that's a great question. I wish I had a crystal ball to answer it, but I would just say that and we - as you know, predominance of our U.S. government business is the Defense business. And so, I think last year were around 59% or 60% of our revenue was U.S. - was Department of Defense.

Of course, we have NASA, Homeland Security and other pieces of it. But what I am hearing in my discussions with Members of Congress is the bipartisan support for defense spending. I mean there is no doubt that the threats are getting greater around the world. We've - you've seen the National Defenses Strategy that came out.

You've seen the National Security Strategy, which I think have been much more direct about the great power competition with China and Russia and also the other players like Iran and North Korea and others. I mean, it's just - it's not getting lighter, it's getting accelerated, and with that we know that not only is there a global threat accelerating and growing, but in addition to that we need to recapitalize.

And so there needs to be expenditure on recapitalization and our weapon systems as well as research and development on all the technology changes and unpredictable nature of the balance space as we're seeing as our adversaries taking advantage of all that technology.

So when you go look at what has been outlined in that National Defense Strategy, it's clear that what is requested aligns very well with our portfolio. I highlighted some of it in my earlier remarks, but all of the things that need to be spent on, whether it's on the nuclear or space or the C4ISR or all those elements of intelligence capabilities and air dominance et cetera are all areas that we play in and that we think our portfolio is very well aligned with.

The one area I think we all are trying to watch is now, how much pressure there will be on putting more spending in the domestic non-defense side of spending. And so, that would be the pressure point that we'll all watch, because I think if you've seen what's been brought forward by the President's - earlier President's Budget request, we're expecting to see the updated one that comes out for 2020, there's been a strong focus on defense.

And so, it will just be a matter of how that plays against the non-defense spending and we are hopeful that it will line up with what we need as a nation, which is to protect our citizens and focus on national security.

Operator

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

David Strauss

Thank. Bruce, I also want to give you my congratulations. Job well done.

Bruce Tanner

Thanks, Dave.

David Strauss

Now I pay you with pension. As far as the contribution, would you mind spelling out exactly kind of what you're thinking about for '20 and '21, now? I think before you were saying couple of hundred million in '20 and like $1.5 million in '21? And then the second parter on CapEx. Can you talk about what you're thinking there and how that kind of comes through in terms of higher depreciation over the next couple of years? Thanks.

Bruce Tanner

David, I'd be disappointed if we had our last conversation and you didn't ask me about pension. So I appreciate the question there. 2020 ERISA contributions, I think we talked about those being in a couple of hundred million dollars level last time we spoke in October.

Again, that was before - the roughly 6% swing in asset returns that happened from October to the end of the year. If those - and this is a little bit fluid, because things can change between now and then obviously with good performance in 2019 and we're actually off to a good start as I'm sure everyone is in the first month or so in 2019 in terms of asset returns, so bear that in mind when I say this, but if we were to have drawn the line at the end of 2018 with the performance when we left it at a 5% negative return. We'd probably see at least a couple of hundred million dollars more contribution in 2020.

And then relative to - I think you said it right, it was about $1.6 billion or so - $1.5 billion to $1.6 billion I think where it was in 2021, probably also a couple of hundred million dollars and you should think of that as back to the phasing of ERISA to recover asset return shortfalls is sort of spread over like a - not quite a decade long, call it, nine years or so. And the recovery from a CAS is sort of spread over a longer period, call it or 12 or 13 years.

So at any one point in time, we'll have more - at the front end of that time period, we'll have more contributions required to ERISA. At the back-end, we'll have no ERISA contributions and peer recovery from a CAS perspective. So think of that again several hundred million dollars up in both years 2020 and 2021 as we sit here today with the potential that that could change based on good performance in 2019.

I'm sorry, David, I forgot, you also asked about CapEx and depreciation. So, we're going to increase capital expenditures in 2019, probably think of it as - I think we finished last year 2018 about $1.3 billion. Our outlook is probably

$300 million or $400 million higher than that in 2017 - 2019 and we'll probably pretty close to that in 2020.

And the drivers of that are some things we have talked about previously. We've got some completion of a facility at our Space Systems, our Space operations in Denver to help with a more efficient way to build and deliver satellites and as well as get some capacity there.

We have got significant growth in Missiles and Fire Control, both from a building perspective to house some employee growth that we talked about on some previous calls, but also both infrastructure equipment and buildings for that matter to increase capacity, primarily in our weapons business, as we talked about previously.

So we're - that's a good news thing. We're spending money to increase the CapEx, but that is in turn increasing the capital or the capacity of our weapons program at Missiles and Fire Control. We've also got and I think I mentioned this previously, we've also got several awards and I know I have mentioned this earlier in the call, but classified contracts sort of around the corporation. Some of those actually come with capital needs as well, but that is to feed, again, the capabilities to support that growing classified business going forward.

So all of those are growing faster than our depreciation recovery as you might expect, but that's good news. That's where the future growth at both the top end and the bottom end of the business will come from and ultimately our depreciation will catch up. It's sort of like the pension asset return. It's just a little bit delayed there. So we're happy to be sending of the capital to the levels we had today and we look forward to the growth of that CapEx will drive from a capacity perspective going forward.

Greg Gardner

John, we're coming over the top of the hour. We'll take one more question.

Operator

And that will be from Carter Copeland with Melius Research. Please go ahead.

Carter Copeland

Thanks for fitting me in, and Bruce let me take a second and also extend my congrats on what's been a great performance on the role. I hope you really enjoy your retirement.

Bruce Tanner

Thanks, Carter.

Carter Copeland

I will stick to the one in the interest of time and that's on MFC and Bruce wondered if you could just may be dig into the performance a little bit there? You obviously had a very strong profit performance and you call that risk retirements and volume are being the source of that. Should we assume that the vast majority of that was risk retirements? Because I would assume that the classified shrink that you called out on the top line would've had a negative mix impact. So, anything you do to kind of help us understand what drove that result?

Bruce Tanner

Yes. I think you characterized it appropriately, Carter. We did have as we closed the year out some really good performance on a couple of programs that resulted in higher risk retirements. We are seeing, as you also point out, some growing volume at lower margins, primarily in the classified arena.

But again if I just sort of rattle off some programs in Missiles and Fire Control that are helping to contribute to some of the higher growth but lower margin business. We're seeing that on the classified business. Missiles and Fire Control is heavily, heavily involved in Hypersonic's work. Indirectly it got some sort of Directed Energy work as well.

The JAGM replacement, so I think of that as the Hellfire replacement is starting to see some early production volume, which is great news but it is lower margins than the legacy Hellfire program. Ultimately, we think that will be comparable but not at this early stage of development and production.

So, a lot of good growth coming. Again, the fastest growing business area in the corporation, both for legacy programs, but frankly most of the legacy growth is going to be a little bit delayed, it requires the capital expenditures that I talked about previously to get most of that growth in there. So, we're seeing that offset in the near-term by growth on a lot of new start programs. And, again, that's the great news, because this is the Cyclone for future growth at Missiles and Fire Control that will last for the next decade or so.

And, as a result of all that, we're looking at margins pretty comparable for the year at Missiles and Fire Control in 2019 to 2018. And, again, just as I said earlier, you should think of that as the programs where you would think margins are improving, they are. And it's sort of being mitigated by a lot of smaller and new start programs with lower margins as they begin their production or development phases.

Greg Gardner

Thank you, John. I think I'll end the call now by turning it over to Marillyn for some final thoughts.

Marillyn Hewson

Thank you, Greg. Before I conclude the call there, I would like to take a moment to celebrate the career and upcoming retirement of Bruce Tanner. Bruce began his career more than 37 years ago in Fort Worth, where he worked on the F-16 program. And like the F-16 itself, Bruce has been a driving force in this company's success for many years. For the past 11-plus years, Bruce has been our Chief Financial Officer, so many of you have gotten to know him through the past 46 earnings calls and his participation in numerous investor meetings and conferences, and you know that Bruce is thoughtful, honest and even keeled.

He's always prepared and he does his best to answer every question that comes from our investors and analysts. And I personally consider it an honor and pleasure to have had the opportunity to work with Bruce in many points throughout my career.

Within our company, we have benefited from his deep expertise, his strategic focus and his leadership. Regardless of the challenges we faced at any given time, Bruce has helped our company grow and flourish. Because of his commitment to mentoring and building up others, his impact and his influence will shape Lockheed Martin for decades to come.

Many of you know that we put tremendous focus on strong leadership talent development and succession planning at Lockheed Martin. That's why as Bruce transitions out, we're delighted to welcome Ken Possenriede as our CFO on February 11th. Ken and I have also worked closely together, dating back to our days leading the Electronic Systems business area and more recently as our Corporate Treasurer and Finance Executive at our Space and Aeronautics business area. His experience and track record are impeccable and I look forward to maintaining our momentum with Ken at the helm of our high end organization.

So we wish Bruce the very best for his well-earned retirement later this year as he returns to Texas to enjoy more time with his family, including his three grandchildren. Bruce, on behalf of our shareholders and our employees, I thank you for your leadership and your outstanding contribution. And Ken, we welcome you to the team.

A - Bruce Tanner

Thanks, Marillyn.

A - Marillyn Hewson

So, thank you again for joining us on the call today, and we look forward to speaking with all of you in our next earnings call in April. So John, that concludes our call today.