Good day, and welcome everyone to the Lockheed Martin First Quarter 2013 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 F. Kircher, III

Thank you, Aly, and good morning, everyone. I'd like to welcome you to our first quarter 2013 earnings conference call. Joining me today on the call are Marillyn Hewson, our Chief Executive Officer and President; and Bruce Tanner, our Executive Vice President and Chief Financial Officer.

Statements made in today's call that are not historical fact are considered forward-looking statements and are made pursuant to the Safe Harbor provisions of federal securities law. Actual results may differ. Please see today's press release and our SEC filings for a description of some of the factors that may cause actual results to vary materially from anticipated results. We have posted charts on our website today that we plan to address during the call to supplement our comments. Please access our website at www.lockheedmartin.com, and click on the Investor Relations link to view and follow the charts.

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

Marillyn A. Hewson

Thanks, Jerry. Good morning, everyone and thank you for joining us on the call today. Before I begin, I want to offer congratulations to our Lockheed Martin team for their outstanding performance that enabled the achievement of strong first quarter operational and financial results while operating in a dynamic and challenging environment. Their focus and efforts have our corporation poised for continued success in delivering solutions to customers and value to shareholders.

While Bruce will cover the financials in more detail later on in the call, I would highlight some noteworthy financial performance in the quarter that included: Growth and earnings per share to $2.33, 15% above last year's first quarter level; expansion of segment operating margin to 12.1%, achieving an increase of 20 basis points above last year's level; and generation of $2.1 billion in cash from operation. Our continued strong cash flow is key to our cash deployment strategy to generate value to shareholders for share repurchases and dividend payments.

In the first quarter, we repurchased over 5 million shares of stock for approximately $460 million and paid slightly under $400 million in dividends. These combined cash deployment actions returned over $830 million to shareholders in the quarter.

We continue to execute our strategy through solid performance on our corporate business and by winning key competitors and follow-on awards to extend our franchise programs. We also expanded our international business activities and continued our measured pursuit and exploration into adjacent new businesses.

Let me begin with a brief summary of our key order bookings in the quarter. Noteworthy awards included Aeronautics receipt of an IDIQ award on the F-22 program for a 10 year fleet modernization and extension under the Raptor enhanced development and integration program, with the potential value of almost $7 billion, and over eight long refunds for 29 new F-35 aircraft to the U.S. government. Additionally, we were awarded funds for long-lead acquisition of four F-35 aircraft for Japan.

Mission Systems and Training received $700 million for two additional Littoral Combat Ships increasing our LCS work backlog to six vessels. And our Aegis team successful won a competitive award for the Combat Systems Engineering Agent program. This award extends our multi-decade legacy and leadership on this important missile defense system.

Finally, our Space Systems team win a long-lead contract to begin construction of two additional spacecraft on the Cerberus Military Satellite Program for the U.S. Air Force. This award brings our backlog to four spacecraft and on this critical national program that provides worldwide Early Warning Detection of Ballistic Missile launches. These new awards and our backlog of future work are direct indicators of the closed alignment of our portfolio of products with customer strategic priorities and requirements and serve as a foundation for the future.

Turning to operational performance, our five business areas continue to execute with exceptional focus and skill in providing critical services and products to customers. While the quarter contained numerous accomplishments, I’d like to highlight two notable successes and provide a brief update on F-35 key events.

First as part of the national strategy to pivot to the Asia-Pacific region, our Littoral Combat Ship, The USS Freedom began its deployment to Southeast Asia. We are extremely proud to have our ship chosen to do the inaugural deployment of LCS class vessels to Southeast Asia. It is a testament to the maturity and capabilities of our innovative multi-mission ship and we look forward to her contributions to the seventh fleet.

While visiting leaders have specific command this quarter, I had the opportunity to go on board freedom, while she was docked in Pearl Harbor en route to Southeast Asia. The pride of the crew and their ship and her capabilities was inspirational and only service to reinforce our critical role to provide these revolutionary warships to the navy.

The next key operational achievement was accomplished by our Space Systems business with their successful launch of the second SBIRS satellite for the U.S. Air Force. I had the privilege to be at the launch site in Florida in March with our customer to watch the event. This satellite joins the currently deployed SBIRS spacecraft and expands the constellation of Early Warning Missile Detection satellite. In this era of increasing proliferation, a Ballistic Missile threats from rogue nations SBIRS provides vital intelligence and defense warning to our country and allies. We are honored to be providing these critical national assets to our country and look forward to delivering the remaining four satellites in our backlog.

Moving to F-35, key accomplishments in the quarter were deployment of C-12 Aircraft to Nellis Air Force Base for operational testing and evaluation and completion of the first operational mission conduced by Air Force pilots. The first operational short take-off vertical landing at Marine Corps Air Station Yuma, successful completion of the 3-Year Wing Flutter Testing Program on the C-12 version with clean results and the first night time vertical landing of Starbow aircraft at Patuxent River Naval Air Station.

These accomplishments highlight the increasing maturity of the program. We are providing increasing levels of aircraft capability and performance to the multiple service branches to enable expansion of pilot training and operational evaluation of this revolutionary platform.

I'd like to now turn to the status of DoD budgets. Since we last spoke in January, the President signed into law, the Consolidated and Further Continuing Appropriations Act of 2013. This act extended funding for the operations of all federal agencies through September 30, 2013. It included full-year appropriations for defense, military construction and veterans' affairs. This continued resolution will fund all other government agencies at last year's level.

With the approved FY13 DoD appropriations of $527 billion, our key programs continue to be supported and funded under the full-year appropriation. Examples of that support we're seeing with the appropriations increasing C-130J procurement to 16 aircraft from previously planned level of seven, and spending of almost $400 million for the continuation of the Meets program. However, funding appropriated through this act remains subject to the automatic budget cuts outlined under sequestration.

We are encouraged by recent alternative budget proposals offered by various members of Congress to modify or eliminate the level of DoD budget reductions required under current sequestration. One version proposes no additional budget reductions to Defense budget levels, while another version proposes approximately $250 billion of reduction from Defense over the next 9 years. Adoption of either of these competing budget versions would represent a significant improvement over the current $500 billion in budget cuts required under sequestration.

Beyond FY13 actions, the President submitted his fiscal year 2014 budget proposal earlier this month. The proposed level for the baseline FY14 defense budget was outlined at $526 billion, a level essentially equal to the current FY13 appropriations level. Initial insight into program priorities contained in the President's FY14 request showed strong alignment in budget support for a number of our key programs such as the F-35 Joint Strike Fighter, Littoral Combat Ship, missile defense systems and higher quantities of C-130J aircraft.

It should be noted that the FY14 proposed budget does not account for the implications of sequestration that went into effect in March 2013. The impact of sequestration on our business has been minimal to date and Bruce will provide some modeling sensitivity on our 2013 financial outlook of sequestration in FY13.

Turning to the global security environment, rising tensions and threats on the Korean peninsula coupled with ongoing conflict and instability in the Middle East only reinforce the complexity of maintaining global security, a need for a spectrum of flexible and effective products to help maintain global security is growing more acute each day. Lockheed Martin products are foundational assets in the preservation of global security.

Recent deployment of our products by the Department of Defense into the Southeast Asia region include placing F-22 fighters in South Korea and deploying the THAAD missile defense systems on Guam, The Littoral Combat Ship with the 7th fleet, and Aegis Missile Defense System. These deployments highlight the key strategic value and determine capabilities of our unparalleled products to national defense. Our portfolio remains in direct alignment with this global security mission and we look forward to providing critical defense and security solutions to domestic and international customers.

I want to turn briefly to our focus and activity with the international customers this quarter. Expansion of international revenues remains a key component of our corporate strategy and we are on a path to grow international sales from approximately 17% of total revenues last year to at least 20% in the next few years. As we've outlined previously, key drivers of that expected growth will be higher levels of international work on the F-35 with growing levels of aircraft deliveries to our partner countries, plus C-130J aircraft, F-16 aircraft and missile defense solutions such as THAAD and Aegis.

Direct and country interaction and listening to the needs of customers are essential components to successful international relationship building. This quarter, I had the opportunity to meet with key customers in Israel, United Arab Emirates, Saudi Arabia and Italy. Discussion centered on how our corporation can help them with their diverse spectrum of security needs that range from fighter aircraft to missile defense systems to cyber security.

While in Saudi Arabia we inaugurated our new in-country headquarters that will enable development of partnerships to create products and enhance our offerings in technology, aerospace and security sectors. A common theme of the meetings was we universally held believe that the global security environment is only becoming more complex and there is a wide spread desire to utilize many of our products and leading edge solutions to solve their most critical requirements.

Before I ask Bruce to give you some color and details on our financial performance, I want to close my comments by providing some insight into three emerging technologies and adjacent pursuits of the corporation. As we have outlined in the past, one of the new technologies we are examining is in the sustainable and alternative energy generation field through a process called ocean thermal energy conversion or OTEC. This technology uses the temperature variations of ocean depth layers to power thermal exchange equipment and generate electricity.

We have created unique intellectual property and expertise in thermal exchange and recently signed a memorandum of understanding to utilize our intellectual property and begin exploration of the design feasibility of a plant to generate electricity on a commercial scale. This agreement is expected to lead a contract that will fund our development efforts for 10-megawatt pilot plant anticipated to be located of the coast of Southern China. We were excited about the potential future prospects of this technology to generate, clean, renewable electricity.

The second adjacent market I'll give you an update on is our expanding commercial aircraft pilot training activities using simulators from our Sim-

Industries business, that develops and manufactures full-motion and fixed-based civil aviation flight simulators for airline customers and independent pilot training centers worldwide. As a leader in commercial simulators for Boeing 737 and Airbus A320 aircraft, Sim recently extended this product line with simulators for the Airbus A330 and Boeing 767, Boeing 777 and Boeing 787 aircraft.

Sim industries broad product offering enabled us to offer a very affordable training solution to the U.S. Air Force's next generation KC-46 Tanker Program. These growing activities and opportunities in this area demonstrate the synergies that exist between the unique low-cost commercial offerings from Sim industries and their applications to future DoD programs. The air force is currently evaluating competitive bids for pilot training on the KC-46 Tanker with the decision on the winning bidder expected later this year.

The third new business opportunity area I'll highlight has recently emerged from our advanced material studies group and is in the area of water purification. We recently received a patent for Perforene material, which is a molecular filtration solution designed to provide clean potable water. The Perforene membrane features holes that are one nanometer or less in a graphing sheet and are small enough to trap sodium, chlorine and other ions from sea water while dramatically improving the flow through of water molecules. This flow through was 100 times better than current reverse osmosis systems, making it more effective at desalination at a fraction of the cost.

Access to clean drinking water is becoming more critical as the global population continues to grow. We believe that this simple and affordable solution has a potential to be a game changer for the water industry. We are also investigating other applications for Perforene such as biopharmaceutical separations and removal of chemical substances and compounds from water used oil and gas wells. The pursuits I've highlighted today are only a few of innovative and expanding portfolio of intellectual property and products that offer future growth prospects for this corporation. We will keep you apprised of our progress in these areas.

I'll now ask Bruce to go through some of the details of our financial performance and then we'll open up the line for questions. Bruce?

Bruce L. Tanner

Thanks, Marillyn. 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 start with chart 3, an overview of the quarter. Sales in the quarter were $11.1 billion, down slightly from last year but ahead of our expectations at the beginning of this year.

Segment operating margin was strong at 12.1%, a 20 basis point improvement over the first quarter last year. Our earnings per share were $2.33, up 15% from last year. We generated $2.1 billion in cash from operations and we repurchased 5.1 million shares in the quarter. So I think we are off to a good start in 2013.

Chart 4 shows our sales for the first quarter this year versus last year. Aeronautic sales decreased by about 14% compared with last year. However, this was slightly better than our expectations when we spoke in January as we had higher aircraft deliveries than planned in the quarter.

Our sales in the other four business areas were also stronger than expected particularly in Missiles and Fire Control, which also benefited from additional product deliveries and volume in the quarter. I should point out that with the implementation of sequestration delayed until March 1, we saw minimal impact for the quarter but would expect that impact to grow as we move forward. I'll discuss sequestration in greater detail in subsequent charts.

Moving to chart 5 in our first quarter segment operating results, our segment operating profit was comparable to last year's level with the increase in margin offsetting the impact of lower sales in the quarter. We continue to have strong program execution and are taking appropriate cost reduction actions as needed. Turning to chart 6 on earnings per share, EPS in the quarter was 15% higher than a year-ago driven primarily by the lower pension expense as a result of our contributions at the end of last year and the benefits of the R&D tax credit.

You remember that we mentioned on the last call that the first quarter would have the benefit of the full-year 2012 credit as well as the 2013 first quarter credit and that's what we're seeing here. On pension adjusted basis, our EPS grew to $2.56 in the quarter.

On the chart 7, we'll discuss our cash from operations in the quarter. As expected, our cash flow in the quarter was very strong at nearly $2.1 billion, more than $1.5 billion higher than the level last year. Although last year's level was reduced by roughly $500 million pension contribution. We not only had strong operational performance, but also had the benefit of a $540 million tax refund in the quarter, resulting from our pension contributions at the end of last year.

We expect that cash generated this quarter will be the highest for the year as we have both pension contributions and tax payments plan in future quarters that did not occur on the first quarter. On chart 8, we'll discuss our cash returned to shareholders. We returned over $800 million to shareholders this quarter through our share repurchases and industry leading dividend yield. The level of share repurchases was almost doubled what we did in the first quarter last year and dividends were higher as a result of our 15% increase last September.

Moving onto chart 9, we'll discuss our updated view of the guidance, we provided on the last call. You recall that our January guidance did not consider the impacts of sequestration. Since then, sequestration did become effective on March 1, but as I said earlier, its implementation had minimal impact on our performance this quarter. Unless revised by Congress however we would expect to see the effect of sequestration having impact throughout the rest of this year.

We try to model these potential impacts by assuming a peanut butter spread of expected reductions to our U.S. government business awarded with FY13 funds. Or said differently, we do not assume any flexibility on our customers' part to favor one programs budget over another.

Using that approach, we estimate a potential $825 million impact to our sales in 2013. With the strong results of each of our five business areas in the first quarter though, we believe our current sales outlook remains within the guidance range we've provided in January and I'll explain that in more detail on the next chart.

Chart 10 shows the methodology we use to develop our estimate of the impact of sequestration on our 2013 sales. At the mid point of our guidance, we would expect just over a three quarters of our sales or about $35 billion to be generated from our year end 2012 backlog and we would expect sales to non-U.S. government customers from orders received this year to be around $2 billion or so, neither of these amounts is expected to be directly impacted by sequestration, however our original estimate of $8.25 billion of U.S. government sales from new orders this year is expected to be impacted by sequestration. As we modeled the estimated impacts over the next three quarters, we project the reduction of around $825 million in sales primarily impacting IS&GS and MST.

On chart 11, we provide our updated guidance. Assuming the modeling from the previous chart and factoring in our better than planned results in the first quarter, we now expect sales will be near the lower end of our guidance range. Even with the lower sales expectation, we are maintaining our side with operating profit and cash guidance reflecting our growing confidence on our performance for the rest of 2013 and we are maintaining our earnings per share guidance range of $8.80 to $9.10 that will emphasize that this range does not include restructuring charges if any associated with sequestration as they are unpredictable at this time.

And finally, we have our summary on chart 12. The first quarter represents the strong start to the year with better than expected sales volume and strong segment operating profit and cash from operations. These results continued for a quite strong program execution, the proactive cost reduction measures we're taking and the strength of our portfolio. And we continue to focus on actions and create value for our customers and our shareholders.

With that, we're ready for your questions, Aly?

Question-and-Answer Session

Operator

(Operator Instructions) Our first question comes from Joe Nadol with JPMorgan. Please go ahead.

Joseph Nadol – JPMorgan Securities LLC

Thanks, good morning and good performance.

Bruce L. Tanner

Hey, Joe.

Joseph Nadol – JPMorgan Securities LLC

Marillyn, I actually had a question for you on the extensive comments you gave on the non-defense portion of your business, which is small. But it seems like you're targeting quite a bit for growth, and really just from two angles, one because as you know this has been a tough thing for defense companies to doing the path to diversify during a downturn.

So the two questions are, one, in your approach to the market, how are you orient in the company to really to impact commercial markets, which is really a bit of difficult thing for companies to do? And I just mean the difference in the customer base relative to the government did some I guess comments there will be good. And then secondly from a risk standpoint, what kind of capital are you putting at risk and how are you considering that going forward? Thanks.

Marillyn A. Hewson

Thanks for the question, Joe. This first half I would say the things that you are seeing coming forward are things that we've been investing in for a number of years. As a company we are a technology leader, we often talk about saying that we do hard stuff, we do difficult things and try to work on big things that are affecting the global environment, the global security environment. So we are always investing in the future in that regard.

And we have 60,000 scientists and engineers that are working on things not only on our core products and services today, but also looking at ways to give our adversaries and advantage or look at new areas that we can help in global security needs. So even as our customer budgets decline, we're going to continue to invest in these new technology so we think that's really important that we do that.

In terms of [ordering] as to commercial markets, I would say that the things that we're doing right now are things that – as I said we've been investing in for sometime and while it is a different customer base they are large projects much like we do large projects across the corporation.

And so to the risk, these are not big needle movers in the near term. We are not looking at a large cash investment we've been investing, for example, the Perforene and the nanotechnologies for the past seven years. We've been investing in the Ocean Thermal Energy Conversion. We've been working on since the 70s. We increased our investment in past five years, but it's measured and disciplined investment that we make in R&D just as we do across the business.

So from that standpoint, it's a matter of not putting any capital at risk, but that we do expect these to be fully funded. In fact, if you look at OTEC, that final plant will be fully funded by our partner as we bring our intellectual property forward in that arena. And in terms of the Perforene, we got a patent, but we are now looking for opportunities to partner and taking that one forward. So we partnered with companies in the commercial market that's what gives us the capability to go into those new markets and that's how we'll approach them.

Operator

Our next question comes from Robert Spingarn of Credit Suisse. Please go ahead.

Robert Spingarn – Credit Suisse

Good morning.

Bruce L. Tanner

Good morning.

Marillyn A. Hewson

Good morning.

Robert Spingarn – Credit Suisse

Marillyn and Bruce a very nice quarter; if I could just go back to the sequester discussion for a moment, I was going to ask Bruce if you could give us a little bit more color on why we don't see more of an earnings or margin impact from the lower sales or is it simply that's what embedded in the range. And then more specifically, Bruce on your modelling discussion you talked about peanut buttering the GFY-13 funding that impacts this year. But what percentage of GFY funding for Lockheed is beyond 2013. I would imagine with the long cycle nature of your product lines, it could be a large percentage?

Bruce L. Tanner

Yeah. So let me try to address both those questions, Rob. So why profit and cash are not necessarily impacted or why we didn't change the guidance for those two elements. First is we did do for sales. You know a lot of it is because of the first quarter quite honestly and obviously we were higher in the first quarter for sales as well but we had good results, pretty much across the board. All five business areas are planned for them in terms of both sales and operating profit. I think as we look forward for the next three quarters, we do expect to see some pressures for the reasons that I described from sequestration.

As I said earlier that not played out at this point. But we do expect them to happen in the next three quarters. As we look out for the planned risk retirements and what we've accomplished in the first quarter, we think those are stronger as we said here today but maybe we thought that be at the start of this year and that's the reason, we didn't change the profit guidance.

Cash flow, obviously, $2.1 billion in the first quarter, very strong, stronger than we had expected honestly and that's the other reason why we think that's going to carry after the rest of this year as well, that's the reason we didn't come down off of our cash as well.

I think your second question was, so how much of the FY13 carries over in for next year? I made the comment, Rob that the sales we got from our backlog at the end of 2012 was about 77%. So think of that is new, see the FY, our calendar year 2013 sales originating 77% of which come from the 2012 backlog, that's not an unusual pattern for us at all. I'll say next year, we would expect it to look very similar to that.

So you should think of that as probably 25-ish may be a little less than that percent of our sales in 2014, will need to come from orders received in 2014 and manifested into sales in 2014. So that pattern as I look back over time has been a fairly consistent one, not at all unusual for what we're experiencing in 2013.

Operator

Our next question comes from Rob Stallard of Royal Bank of Canada. Please go ahead.

Robert Stallard – RBC Capital Markets

Good morning.

Bruce L. Tanner

Hi, Rob.

Marillyn A. Hewson

Good morning.

Robert Stallard – RBC Capital Markets

A quick question on capital deployment, do you expect that to be more consolidation in the defense industry as we see [the year] is playing out and would you see Lockheed being participating in that? And also to follow-on from your comments Marillyn about these adjacent markets, would you potentially be interested in acquisitions in line with more diversified areas, not just defense?

Marillyn A. Hewson

In terms of consolidations on the defense industry, I think you know as the spending contracts, we would expect that there would be more consolidation, it's just at that level and it's been communicated to us by our customers, I think that at the prime level, it's about right in terms of the number of companies that are prime, so we're probably get to second and third tier or below but we will see consolidation. But I certainly expect that because the economics will dictate that with the contraction of the budgets.

In terms of acquisitions and to broadening our acquisitions, we're going to stay into the near adjacencies. We prefer to do joint ventures and teaming where it makes sense and we'll continue to look at our acquisition strategy as String of Pearls approach and look at what will line up with the capability that we need and the markets that we want to moved into.

Operator

Our next question comes from Doug Harned of Sanford Bernstein. Please go ahead.

Doug S. Harned – Sanford C. Bernstein & Co. LLC

Good morning.

Bruce L. Tanner

Hi, Doug.

Doug S. Harned – Sanford C. Bernstein & Co. LLC

I'd like to understand how you're thinking about the longer-term top-line outlook, because on one hand if I look at the backlog so to say played out in this quarter, it means, as I look at it, IS and GS appear to the most worried sum in that, obviously you could get it by sequestration. When you talk about contraction, it's in the budget.

It sounds like you are looking at a shrinkage overall in your top-line and if I pair that up against the new ventures you're talking about going into, I mean I know that OTEC and the reverse osmosis purification program, this were going on 15 years ago. Are you looking at reading those forward more as a substitute for a contraction in the defense revenues? So, if something happen technologically that's caused us to lead forward and become a more prominent effort.

Marillyn A. Hewson

Thanks for the question, Doug. Just to address, where we see our growth, we do know that our core domestic defense business will flatten, potentially decline. So what we are focused on is growing our international business that is where we expect that to offset that and continue to grow.

As I've said in previous calls and today as well we are currently at 17% of our sales. We expect to grow that to 20% over the next few years, but we will continue to focus on where that demand is from missile defense or [attack area] or immobility, a lot of our C4ISR satellite technology. It's a whole range of products, but it continues to be a strong demand for internationally. In terms of these adjacencies and some that I talked about today, these are not needle movers in the near term.

These are really those that we believe are long-term with large application potentially in these technologies and they are not new to the horizon for us. As I said, we have been working on them for a number of years. The fact that some of them have come to fruition, we are dealing with different partners and different customers and so they are once that have come about in the last few months that have come on the screen and we thought it would be appropriate to share with you what is happening in those, but our top line growth will be on our core and near adjacencies both domestically and internationally in the business.

Bruce L. Tanner

Doug, I might add just a little bit. I think on your last question you asked about the technology aligned at this point in time and I think that's probably a fair characterization. I think they have aligned here. We've been experimenting with some of the early materials that led up to the Propane products for probably the last seven years or so through our advanced materials organization and that is – what's just come out here, I think at the end of 2012 is where the product that we think provides us sort of capability that we've described with Perforene On the OTEC side, as Marillyn said earlier, we've been doing that literally since the 1970s.

We actually had a pilot plant in Hawaii, off the Coast of Hawaii, that's been working as much, much smaller scale than the one we're talking about, building going forward, we've had that operating for probably the last five years or so. So, some of the technologies has come together, some has just been ability to scale those technologies, particularly in the OTEC side of it. And so I think that's what we're seeing, it's sort of the combination have been coincidentally they're all sort of materializing here at the same time; frankly, very opportune time for us, because that's where we are seeing some pressure with our largest domestic customer.

Operator

Our next question comes from Jason Gursky of Citi. Please go ahead.

Jason Gursky – Citi Investment Research

All right, good morning everyone.

Marillyn A. Hewson

Good morning.

Bruce L. Tanner

Good morning.

Jason Gursky – Citi Investment Research

Just a clarification question and then a more medium one, on the adjacencies, can you talk about where you are from the percentage of revenue today and what your targets are? And then, is this a question of potentially selling these intellectual property rights, which you developed here?

And then on the needy question Bruce can you talk a little bit about the cadence for cash for the rest of the year giving all the moving pieces with the pension contribution, the tax payments. And then, we also like think you have got the DoD moving from net pay of 15 days and 29 days, I'm just wondering if that's going to have any impact on the cadence of the cash for the rest of the year?

Bruce L. Tanner

Yeah, Jason, good question. Let me try, I'll answer both and see if Marillyn wants to add anything to what I would come up with. So on the adjacencies how big, you should think of this being fairly small, may be literally as below 5% of our overall sales right now, we're hoping to grow that some going forward, the biggest elements we've got right now are in our energy business as well as our cyber security business, and those are two that we've talked about fairly consistently on the calls. You should think of those as again being tough, I'll say low single digits percent of the overall sales in the corporation not into growth those going forward.

The products that Marillyn described in her prepared remarks, will just add to that but not significantly I'll say over the next five-year period of time. We are just really trying to convey the message that we like to think and we do difficult in all these projects that we are talking about have difficult in their middle name if nothing else, and we think we are riding our capabilities and the innovative capabilities of our workforce with products or with problems that need to be solved on a big scale and that's what we are trying to see it for you.

As far as the cadence for the cash, I'm glad you asked that and I hoping to work that at some point of conversation anyway, so obviously we are not going to do $2 billion a quarter when we are out looking $4 billion for the year. You should think we had no pension contributions and a tax refund in the first quarter of this year. We should be – over the next three quarters we should have pension payments in the second quarter and third quarter. We'll actually had two tax payments just the way the calendar lines up in the second quarter and then the tax payments in the third quarter and fourth quarter.

So what you should see especially in the second quarter is we will have cash flow down considerably, I mean probably to the point of on a free cash flow basis slightly better than positive we're hoping but down its pretty significantly. And then I would expect it to grow up to the $800 million, $900 million in the last two quarters or so is what the expectation as we said here.

You've asked about the payment cycle and so forth. And I'll tell you, we've and I think the industry in large are seeing actually pretty good performance out of payment officers where we get the most the bulk of our collections from our customer. They've been paying typically quicker than sort of the statutory rates that have been paid in the past.

What I am watching for going forward in particular, Jason is the effects of workforce furloughs on the part of the U.S. government and particularly is that affects our paying officers. And so you can imagine a scenario where people will be furlough, I think the current pick in the government is one day for 14 weeks in the months ahead.

And the question is so, is everyone paying contractors sufficient in four days as they are in five, I got to believe that's not going to be the case. I will say though that's expected to be an impact in the fiscal year and not necessary for the calendar year, because obviously the fiscal year went in September and we would expect that the next calendar not to had those sorts of furloughs of leases we said here today.

Operator

Our next question comes from Rich Safran of Buckingham Research. Please go ahead.

Richard Safran – Buckingham Research

Hi, good morning.

Marillyn A. Hewson

Good morning.

Richard Safran – Buckingham Research

I wanted to ask you about book-to-bill. So if I did it right, looks like a book-to-bill of roughly 0.6. And I think that's about what you did one quarter last year? So I thought maybe you could comment on expectations for book-to-bill this year and how you feel about full-year book-to-bill being either one times or higher?

Bruce L. Tanner

Yeah, I'll try that one Rich. So I think your math is right. It was a 0.6 book-to-bill. Actually as we look at the first quarter orders, we actually did better than we expected to do, pretty much across the board for orders for all our business areas. And in particular, I will say, I think that is one of the reasons why some of our short cycle businesses like IS & GS and sort of the services component of MST actually faired better in sales in the first quarter because we did actually receive slightly higher orders in the quarter than we'd expected to.

Going forward, I think second quarter is going to be the lowest quarter from a backlog perspective of the year and then we would expect it to rise thereafter. So we expect second half orders to be higher than first half and the fourth quarter to be the highest quarter of all the quarters if you will. And that's our typical pattern anyway. There is a couple of things I'll point to that you might be watching out for in the second quarter.

We have a few high dollar items, mostly within our large business areas. So we would expect to get at the second order for close, the second order for 18 aircraft for S-16 aircraft I should say for Iraq, probably get in order for couple of C-130s from Saudi Arabia. There is a possibility we'll close on the Indian C-130 a second and C1-30 by for India for six aircraft. We still have six international aircraft and launch six for F-35 that yet to be sort of fully funded via under an undefinitized contractual action or UCA that we would hope would happen in the second quarter.

We should get additional funding for even greater aircraft on LRIP-8, for F-35. And then switching to MST, we should be getting finalization of the MH-60 Denmark helicopter contract and some ground radar business within MST. So those are sort of the dollar awards that you want to watch the high dollar awards.

Strategically, there is a couple of big items as well, almost all of them within MST in the second quarter. So the Air Missile Defense Radar AMDR program, we expect to be awarded in the second quarter as was space side, this is the sort of the Space Debris Tracking radar if you will from earth that we expect to happen in the second quarter.

And then lastly within MST, the KC-46 Training activity that Marillyn mentioned in her prepared remarks is also something that we would expect to happen. Either late in the second quarter, early third, the rest of the year, we are hopeful obviously we got some missile defense products pack reason for a number of customers within the Middle East.

And then recently if you saw some of the FMS activity just came out, we are hopeful to have some weapons on F-15s and some capabilities for helicopters in Saudi Arabia as well as the potential to sell additional F-16s to the UAE. So whether that one will happen between now and end of the year, it might be a little bit sporty but we're focused on that and hopeful that that could occur. I should mention probably that we've also got activities within Singapore and South Korea for the F-35; again, not sure if those will happen this year or not, but they are on the custom, ones that we're watching very closely.

Operator

Our next question comes from George Shapiro of Shapiro Research. Please go ahead.

George Shapiro – Shapiro Research

Yes. Good morning, Bruce.

Bruce L. Tanner

Hi, George.

George Shapiro – Shapiro Research

One little one and then one I'll put together. You mentioned a contractual settlement on the F-16 in the quarter. Could you kind of ballpark, how big that was? And then a macro question is if you look at historically defense outlays and track them against military contractors very rarely does the military contractors vary a heck of a lot from the numbers, and if you look at 2014, the outlays for procurement in R&D probably going to be down at least 10%. So I guess I asked the question why won't your revenues be down similar to what you would expect…

Bruce L. Tanner

Yeah, so George, I'll take those. So F-16 the contractual resolution you should think of that being in and nothing sure to approach 10, but think of it in the 10ish million dollar range maybe little less than that. So not a particularly huge item, but one that's been outstanding for quite a while and we're delighted to have and finally settle now; I literally think this is one that is probably been around. As I have quite a few of these contractual resolutions, we have had settled in the past for probably close to a decade. So it is good to get them behind us.

As far as the outlays, you're looking at the defense outlays versus the contractor, you know what, I will remind you again that 61% of our sales roughly last year were from the DoD. So there is a full almost 40% that's non-DoD, obviously the biggest component that is the international, we do expect as Marillyn said earlier to grow the international component of our business which would help to maybe explain why we don't get down to 10% you are talking about there.

And then what I would suggest George is that, even within that reduction in the procurement R&D, you have to look at the individual programs within the DoD budget because not every partner within the DoD budget is going down 10% and it ties into the priorities of the customer and our alignment of our portfolio with those priorities.

So we would expect the F-35 to grow our air and missile defense programs to grow and help to offset that on the international side obviously as we mentioned earlier, the air and missile defense components especially growing over the next few years. It helps to offset that reduction. I think you're seeing in the – and sort of the high level map that you described.

Operator

Our next question comes from Howard Rubel of Jefferies. Please go ahead.

Howard Rubel – Jefferies & Company, Inc.

Thank you. I want to ask more of an operational question and for example if we look at aeronautics, Marillyn, you were able to hold the decline, for example on the C-130 to about $10 million, despite seeing a $175 million decline in revenues, which is pretty impressive sort of action.

And, if we look across some of the other businesses despite, difficult revenue numbers, the margins were pretty darn good. Could you talk a little bit about with some detail on some of the things you're doing whether it's head count or for space and you know, because no matter what happens with the sequester. I think there is just going to be a real utmost pressure on the business for a while?

Marillyn A. Hewson

Howard, we're definitely focused on operational performance, so I think you characterize it well in terms of talking about it being operational because we've been, we not only are we driving improvement even if we reduce the rate on the C-130J, we are able to hold our position relative to profit on the program.

So, I think you're seeing the results of that and at the same time, we're very much across our business, working on reducing cost and increasing efficiencies and productivity in the business; so a lot of activities, not just operationally with our particular program but all of that flows through to all of our programs.

So the things that we're doing in getting out of facilities and reducing our overheads and the efficiencies that come with, just having a razor focus on cost across every element of the business is helping us to bring in better performance. And then within the C-130J, I mean as it moves through its courses you have a learning curve and so continuing to have productivity improvements as we continue with the rate of that program.

Bruce L. Tanner

Howard, just a interesting little [titbits] there. And my aeronautics friends have pointed this off to me as we've done reviews with Marillyn and the leadership team there. We've actually for the past few C-130 since we've started building at 24 aircraft a year, the hourly rate or the hours it takes to assemble that C-130 is we're actually performing better than we were – when we were delivering 34 aircrafts a year.

So that's no small feat when you are on number what 4500 aircraft, not 4500, 2500 aircraft through the line, and at this stage of the product development or product manufacturing cycle that we've been able to make that those are real live reductions and it's one of several instances that we can point to there, we're taking the right actions particularly on a manufacturing side of bringing down the product cost in line with the shrinking volume that we're seeing.

Operator

Our next question comes from Myles Walton of Deutsche Bank. Please go ahead.

Myles Walton – Deutsche Bank Securities

Thanks, good morning. First one is a classification, Bruce I think you had previously talked about $8 billion in backlog and in the year and can't recall that was with sequestration without and if that number had changed?

Bruce L. Tanner

Yes, so Myles, I think what I have tried to key up is that we always expect that we take a downturn in the first quarter, probably get further down a second quarter, I think at the start of the year, I said we hope to get back around the $80 billion mark that still obviously a goal that we have, but I think it's going to be tougher assuming that the next three quarters are hit by sequestration. So those numbers, you remember them right, it was $80 billion. But I'll say that's probably a tougher – as we said here today because that did not compare the effects of sequestration.

And of course we would think that orders in the fiscal year since we had more of our orders obviously coming from that fiscal year 2013 funds would be more significantly impacted them with sales in calendar year 2013, because less of those come from fiscal year 2013 fund.

So it would be a bigger number than the $825 million of sales impact is what I would expect from an orders perspective. But we're not yet at this point giving up on that and hopefully as quarter's go by, I also have a better idea what that looks like and we'll be able to update that for you as we go through the year.

Operator

Our next question comes from Cai von Rumohr of Cowen & Company. Please go ahead.

Cai von Rumohr – Cowen & Company

Yes, thank you and great performance.

Marillyn A. Hewson

Thank you.

Cai von Rumohr – Cowen & Company

Bruce, one of the things you highlighted was that EACs were better than expected. It was 470, 35% of sales, that's substantially higher than it's been in any of the last couple of years. Where do you expect it to be for the year? And two questions, give us some color on the quarterly pattern as you did with the cash flow? And then where notionally can this number go in the future as it likely to come down than more normal levels or is it still sustainable? Thanks so much.

Bruce L. Tanner

(inaudible). So EACs at least as I look at Cai, we actually we're a little bit lower in terms of profit adjustments in the first quarter of this year as compared to what we did last year. So think of it, still in the sort of mid 30-ish range, but slightly less I think about $15 million bucks or $20 million bucks less this year versus last year.

U.S. for sort of the pattern going forward, we would expect to be within probably the 30% to 35% range each and every quarter going forward probably down a little bit from last year overall, but of course the sales and the segment profit are expected to be down this year compared to last year, so that's probably following suite for the lower volumes that you see there.

Nothing really jumps out as I look at it as far as spikiness as we sit here today in terms of the pattern going forward, that obviously changes as we do risk retirements, we do them when we retire the risk not when we necessarily plan to do the risk. So when I describe the pattern going forward, it's when we plan to do but we can obviously do better or worse than that.

We really don't have a reason to believe to the future necessarily going to look any differently in the past. I know that's been the subject of a lot of riding but it is the same methodology we've used consistently for a long, long time and that has been our pattern. We've got to describe that over time, I think last year was the best odd in a couple of quarters because we had some large contractual resolutions that sort of jumped up that were are not in our historical levels. But going forward what we see is still sort of in that 30% to 35% range and not much change for that, Cai von.

Cai von Rumohr – Cowen & Company

And then you mentioned that it was better than you expected, how much has that changed? You mentioned that was a plus for the full year to offset the lower sales. Is that how much better does it look now approximately?

Bruce L. Tanner

I don't know I have got the numbers at the top of my head, Cai. But I would say we were not expecting. We got the benefit of both volume obviously. I mean I think on the last call I teed up that we are probably going to be down a billion dollars year-over-year in the first quarter. We ended up being down what about $800 million. We again across the board, all five business areas were better in sales, better in profit.

The sales obviously brought volume in terms of profit on those sales. If I had to get some number out, probably offset maybe about 50-ish plus million dollars is probably what I would guess that happened earlier and somewhat higher than we had expected kind and that's a little bit off the top of my head and we'll see what that looks like going forward. But again I don't see a huge pattern shipped as we go forward in the next three quarters from what we did in the first quarter.

Operator

Our next question comes from David Strauss of UBS. Please go ahead.

David Strauss – UBS

Good morning.

Bruce L. Tanner

Hi, David.

Marillyn A. Hewson

Good morning.

David Strauss – UBS

Bruce, going through your sequestration map as it relates to 2014, is there anything besides international that would offset overall revenues potentially being down in the high single digit range? And then Marillyn, a question for you in terms of sizing the business for sequestration, you obviously highlighted here further restructuring of IS&GS. Can you just talk about maybe broadly how you view the business size wise, from a head count perspective if sequestration does go through in full effect? Thanks.

Bruce L. Tanner

Yes. So David, you asked me the first part of that question. So again what I try to key up and I won't just simply repeat myself but we do tend to have a very similar pattern as far as the amount of sales that we derived from backlog year-over-year. So as we've talked in the past, our long cycle businesses, Aeronautics and Space in particular get 90% plus of their in the following year from the backlog from prior years, that goes down. Probably IS and GS is our lowest business that gets in terms of the percentage of sales that are derived from previous years backlog. I think about, that's probably 65-ish percent or so, 35% comes from new orders turning into new sales in the year.

The thing about 2014 that I think we all have to remember is, 2013 is the peanut butter or across the board cuts. 2014 with the new President's budget, there is no peanut butter cut, so they can actually cut whatever – I'll say aligned with the strategy starting in government fiscal year 2014, that's different then what we saw or what we will see in fiscal year 2013 and where I would offer up, this is sort of the proof of the putting or whether or not your portfolio aligns to the government's strategic interest or not in terms of the DoD's priorities.

We think ours does – we think ours has more staying power in that environment than in a peanut butter environment, and that's what I think, David I think is maybe all that will understood that I think it does make a difference as we look into FY14 versus FY13.

David Strauss – UBS

Hi, Marillyn.

Marillyn A. Hewson

So, you address the sizing of the business for sequestration. Now we're going to size the businesses as we get more clarity from our customer. Frankly it's difficult to forecast, I know Bruce talked a lot about modeling, but it really was – the best we could do to model what that impact would be until we get better insight on their planning for sequestration will be difficult to say which programs get hit and therefore which program what kind of head count might be modified accordingly. So, there is a lot of uncertainty here.

As Bruce said though, we look at the budget request for FY2014, it does certainly support not only the national security strategy but it also very much aligns with our portfolio. We'll continue to invest in new technology, we'll continue to drive down our cost and I think we remain well positioned to succeed in this environment going forward.

David Strauss – UBS

Aly, if I could, maybe one last question please.

Operator

Our final question comes from Sam Pearlstein of Wells Fargo. Please go ahead.

Sam Pearlstein – Wells Fargo Securities

Thank you. I said I want to go one in. Hey Bruce, can you discuss a little bit about the sales, before you had said sales for the quarter would be about a $1 billion below and then you came in a little bit better on aircraft deliveries but it looks like almost across the board, MST and MFC, IS & GS space all running ahead of what you said you would be doing in the 10-K in terms of the full-year. So is there a reason why there was so much front ended and what is that mean for the progression of the different quarters?

Bruce L. Tanner

Yes, good question, Sam. So I try to tee that up, I think what Cai von asked the earlier question that they maybe more higher in the first quarter as expected. I teed up being about a $1 billion down, we actually have been $200 million down, so there is $800 million of goodness there. I think if it is a couple hundred million within Aeronautics probably for a couple of C-130s earlier delivered than planned.

The rest of those volumes, Missile & Fire Control was up on just a percentage basis like 13% year-over-year in the first quarter. Most of that was the facing or timing of deliveries of products there. So think of it is in particular tactical missiles JASSM, missiles the Multiple Launch Rocket System activities there. That's earlier than planned but not necessarily upper for the year as we look at this at the end of the first quarter.

We also saw higher volume just I'd say cost volume from a couple of awards including within SOF CLS and with the (inaudible) sniper activity with the Missiles and Fire Control. Some of our short cycle business, I'll say we were very pleasantly surprised in the first quarter, I mentioned earlier that we were going to – that we actually exceeded our orders expectations in the first quarter even though you're looking at that as a 0.6 book-to-bill ratio that was actually slightly better than expected. And on our short cycle business, we think that did translate into higher sales in the quarter as well.

So not sure if that was last throughout the year, that's one of the reasons we put the guidance out that we did, but we're pleased to have that in fact in the first quarter, I think some of that is because we frankly saw, I'll say a sense of urgency to get things under contract prior to the end of last year when we thought sequestration was going to start in early January, I think we experienced a similar phenomenon at the end of February when the customer thought that sequestration was going to get in effect on March 1, a number of customers thought that obligated funds would that be subject to sequestration if obligated prior to that.

I think we got bit of a rush to kind of get those under contract, I think we're seeing the benefits of that on our short cycle businesses. So maybe just to finish off my long dialogue here, but going forward the next few quarters, I think our sales levels are going to be similar in the second quarter and third quarter to what we experienced in the first quarter maybe down slightly, because sequestrations largest impacts at least as we look for the rest of the year going to occur in the second quarter and third quarters, because you're kind of squeezing the full government's fiscal year with sequestration cuts into the last two quarters of the fiscal year.

So for us that the second quarter and third quarter of the calendar year, I think we'll see bigger reductions there, I do think fourth quarter will be the largest quarter of the year going forward even with the potential reductions that have yet to be announced in fiscal year 2014 from sequestration. So that’s sort of how I think of the – again the next three quarters similar, may be a little bit down, because the sequestration to the first quarter and then a pop up in the fourth quarter.

Marillyn A. Hewson

So to wrap up, I’d like to thank you all for joining the call today and for your questions and we look forward to speaking with you in July. Thanks.