Good day and welcome everyone to the Lockheed Martin First Quarter 2015 Earnings Results Conference Call. Today's call is being recorded. At this time, for opening remarks and introductions, I would like to turn the call over to Mr. Jerry Kircher, Vice President of Investor Relations. Please go ahead, sir.

Jerry Kircher

Thank you, Karen, and good morning, everyone. I would like to welcome you to our first quarter 2015 earnings conference call. Joining me today on the call are Marillyn Hewson, our Chairman, President and Chief Executive Officer and Bruce Tanner, our Executive Vice President and Chief Financial Officer.

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

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

Marillyn Hewson

Thanks, Jerry. Good morning, everyone and thank you for joining the call today. We are pleased to have you join us to review our first quarter results. As today's release outlined, we had another solid quarter operationally and financially. The corporation continues to deliver critical solutions and products to our customers, while also returning value to our stockholders. I am extraordinarily proud of the efforts and focus of our team and their significant accomplishments across the corporation.

And looking at the results for the quarter, we achieved or exceeded our expectations. I am very pleased that strong year-to-date financial performance across multiple business areas enables us to increase 2015 full year guidance for operating profit and earnings per share. In addition to these increases to guidance, we reaffirmed our earlier outlook for full year orders, sales and cash from operations. In addition to these solid financial results, we have continued to return value to stockholders in the areas of share repurchases and dividend payments through our cash deployment initiatives.

In the quarter, we repurchased over $600 million of our shares and remain committed to achieving the goal we outlined earlier this year to repurchase at least $2 billion of our shares in 2015 market conditions permitting. This ongoing repurchase program enables us to progress on our related goal of reducing total outstanding share count to below 300 million shares by the end of 2017. These repurchases combined with our quarterly dividend repayment returned over $1.1 billion in cash to stockholders this quarter.

Turning briefly to DoD budgets, in early February, the President released his proposed fiscal year 2016 base defense budget at $534 billion, reflecting a request with $35 billion more than the spending limits established in the Budget Control Act. The President also proposed an additional $51 billion in spending for overseas contingency operations, or OCO. Combined, the two proposed spending packages totaled $585 billion and if enacted represent a significant increase in total funding for defense above prior year levels.

In March, budget resolutions were passed by both houses of Congress that outlined total defense spending level that equals or slightly exceeds the amount requested by the President. The congressional resolutions are a bipartisan recognition of the need for greater investment in defense spending to respond to increasing global security threats, aging military assets and the imperative to improve the readiness of our Armed Forces. The resolutions left in place, the Budget Control Act sequestration cuts to the Defense Department space budget, while increasing funding for the OCO, overseas contingency operations. This approach is intended to enable utilization of funds from the OCO to pay for other defense items outside the normally restricted war-related costs specified in the OCO. While it is too early to predict the final level of FY '16 defense budgets, it is encouraging that the President and Congress are aligned in their recognition of the need to increase defense spending from the recent constrained levels. We look forward to finalization of congressional budget deliberations which are expected to be completed later this year.

Moving outside the DoD budgets, momentum continues to build with respect to our strategy to expand international business and the success of this strategy remains a priority to me and the corporation. This past quarter, I had the opportunity to travel to multiple countries in Europe and the Middle East to participate in wide ranging discussions on our spectrum of products and services and the increasingly complex geopolitical environment, which requires proven and adaptive solutions at home and abroad. In Europe, I had the opportunity to participate in the Munich Security Conference on international security policy. This meeting included extensive discussions on current and future security challenges and included attendees from more than 70 countries who exchanged views on defense requirements.

Well, in the Middle East, I was able to travel to both Saudi Arabia and the United Arab Emirates where I met with senior government leaders who discussed these current and future regional security issues they face and how we might work with them to address their requirements. These discussions reinforced my belief that our international growth strategy is sound and working. There is an acute need on the part of international customers for an increasingly wide range of our products and services as the geopolitical environment becomes more complex and less predictable. These expanding requirements further position the corporation to achieve our goal of generating at least 25% of annual sales from international customers in the next few years.

I would like to move to the F-35 Joint Strike Fighter and provide a brief summary on the progress of the program that we are achieving and reaching key milestones and securing new business from international customers. Recent production milestone accomplishments included rollout of the first F-35A aircraft from the final assembly and check out facility in Italy. This represents the first time an F-35 has been assembled outside the United States. It also demonstrates the ability of the Italian facility to complete the fifth generation stealth aircraft and underscores the global partnerships within the F-35 program. Beyond this production accomplishment, the flight test program continues to progress with completion at the 1,000 sortie at Luke Air Force Base, the 500 sortie at Nellis Air Force Base and the overall F-35 fleet surpassing 30,000 flight hours.

These events highlight the increasing tempo of flight operations across the country at an expanding number of sites. New business support of the program continue to grow internationally this quarter with letters of acceptance signed by Israel for 14 additional aircraft and by Turkey for four aircraft. Additionally, the Netherlands placed an order for its first batch of eight production aircraft. These recent actions reflect the expanding commitments by international countries to secure this fifth generation aircraft for their future fighter fleets. It’s noteworthy that the program of record identifies over 700 aircraft to be acquired by 11 international countries and illustrates the strong future demand for the F-35 by our allies. Almost half of the projected annual orders over the next 5 years are scheduled to be placed by international customers, demonstrating the importance of international participation on the program.

Turning to the development program, we have continued to finalize the software that will enable initial operating capability or IOC of the STOVL aircraft for the U.S. Marine Corps later this year and are also progressing on the software that will enable the Air Force variant aircraft to achieve IOC in 2016. This past quarter, we successfully conducted initial flight test of the enhanced software that will be used to provide IOC to carrier variant aircraft. The commencement of these flights with this software is the key element to enable us to provide this revolutionary aircraft to the U.S. Navy in 2018. Overall, the F-35 program is retiring development risk, increasing the production tempo and securing new contract awards as we expand our activities on the program.

Before turning the call over to Bruce, I want to highlight two noteworthy milestones that occurred earlier this month in our aeronautics business and a key event this past quarter in our Mission Systems and Training business. On the Aeronautics C-130 program, we were enormously proud to celebrate the 60th anniversary of the rollout and first flight of the inaugural production C-130 Hercules in April 1955. With almost 2,500 C-130s delivered around the world to 63 countries, it remains the world’s most fielded cargo aircraft. The C-130 program has the sole distinction as the world’s longest, continuously operating military production line.

Since the debut of the A model 60 years ago, the C-130 has incorporated multiple model revisions, product improvements and upgrades, and it’s evolution to the J version produced today. This 60-year history of continuous improvement also created demand by commercial customers seeking to reconstitute their aging L-100 airlifter fleets with a new LM-100J version extending the footprint of its program beyond domestic and international government customers.

On the C-5M program, a super galaxy aircraft recently established 45 pending new world records in airlift capabilities. And after the results are certified, we will hold a new total of 86 aeronautics records. Our upgrade program to install 25% more powerful and fuel-efficient engines on the aircraft has significantly enhanced the ability of the C-5M to reach speeds at a faster rate than predecessor versions and enable cargo transport over longer distance between refueling. We are very proud of our upgrade actions on this airlifter as we deliver expanded strategic air mobility capabilities to world fighters. With unmatched flexibility, versatility and relevance, the C-130 and C-5 aircraft will continue to provide essential airlift service for our nation and international users for years to come.

Turning to Mission Systems and Training, in February, we were honored to participate with the Air Force at the groundbreaking ceremony at Kwajalein Atoll to mark the start of the construction for the Space Fence radar system. This ground-based radar system will improve the way objects are tracked in orbit and increase the ability to predict and prevent space-based collisions. The multi-year program will also serve as one of the drivers for future sales growth in the MST business area as we deliver this critical enhancement to our national capabilities.

I will now ask Bruce to go through the details of the first quarter financial performance and our increased 2015 guidance and then we will open up the line for your questions.

Bruce Tanner

Thanks, Marillyn. Good morning, everyone. As I highlight our key financial accomplishments, please follow along with the web charts that we included with our earnings release today.

Beginning with Chart 3, we have an overview of our first quarter results. Sales for the quarter were $10.1 billion and this was in line with our expectations. We will provide more color on our sales results on the next chart. Our segment operating margin was better than expected in the quarter at 12.9% and enabled us to achieve earnings per share of $2.74. We generated $957 million in cash from operations also in line with our expectations, but lower than we have historically generated in the first quarter. We will discuss the quarterly phasing of our projected cash from operations for the year in a few charts. Our cash deployment actions remain strong with $1.1 billion of cash return to shareholders, including more than $600 million in share repurchases. And because of our operating performance in the first quarter, we are increasing our full year outlook for both operating profit and earnings per share. So, I think we are off to a very solid start to 2015.

On Chart 4, we compared our first quarter sales results for 2015 with our results in 2014. Sales are lower by about 5% compared with the first quarter of last year, but as you recall, we said that this was our expectation during the January call. The lower sales level was driven primarily by two business areas, Missiles and Fire Control and Aeronautics. In both cases, fewer deliveries drove the reductions, PAC-3 and tactical missile deliveries and Missiles and Fire Control and three fewer aircraft deliveries in aeronautics. We remain on track to achieve the sales outlook we provided at the beginning of the year.

Chart 5 compares our segment operating margin this quarter with the first quarter of 2014. Segment operating margin was 50 basis points lower this quarter compared with the same period last year, but remained near historically high levels. Three of the five business areas had higher margins this year than in the first quarter of 2014 with Space Systems having the largest increase due to higher risk retirements. Mission Systems and Training had a strong performance quarter, but was unable to match its near record level margin results from the first quarter of last year.

IS&GS' margin was down considerably from last year at this time, though we had expected a fairly large reduction when we provided our outlook for the year in January. The first quarter results were lower than expected due to performance issues on an international program. Results from the rest of the IS&GS portfolio of programs were stronger than expected and we are able to offset much, but not all of the impacts of this program. Overall, our performance was better than expected and resulted in our increase in segment operating profit for the full year.

Turning to Chart 6, we will review our earnings per share results this quarter with our results from a year ago. Our EPS of $2.74 was $0.13 lower than the results from last year, but higher than our expectations and because of this, we increased our EPS for the year as we will discuss in a few charts.

Chart 7 provides details into our cash deployment actions during the quarter. And as we previously mentioned, we repurchased more than $600 million of our shares in the quarter, more than we had planned in our initial guidance projections and combined with dividends paid of nearly $500 million when we returned $1.1 billion of cash to our stockholders or 131% of our free cash flow in the quarter. We expect to have a larger amount of share repurchases in the second quarter, utilizing the greater level of cash we have on the balance sheet as a result of the debt issuance we had in late February.

On Chart 8, we discuss our updated outlook for our full year 2015 results. We are not changing our guidance for either orders or sales at this time, though orders in the first quarter were slightly ahead of our expectations. Sales, as we mentioned earlier, were as we expected in the quarter. We are increasing our profit projections by $50 million as a result of our strong performance in the first quarter. We are also increasing our earnings per share guidance by $0.05, but there are several moving pieces that deserve more explanation and we will provide that on the next chart.

We are leaving our cash from operations guidance unchanged, but I do want to mention that our phasing this year will look different compared to our results in recent years. We expect that our quarterly cash phasing will be significantly weighted towards the second half of the year with as much as two-thirds of our cash coming in the last two quarters of the year. We expect this phasing in part because our cash collections will mirror the increased delivery rates we expect throughout the rest of the year, and we anticipate reaching final agreement on a number of contracts in the second half of the year that will bring cash collections with them.

Chart 9 provides a reconciliation between our prior EPS outlook and our current expectations. The increase in our segment operating profit outlook will increase our expected EPS by $0.11 per share. As we previously mentioned, our share repurchase activity in the first quarter was slightly higher than we had planned and we also had a lower level of options exercised in the quarter than we were expecting. The combination of these two items results at a lower average share count level than our previous projections and improves our estimated EPS for the year by $0.07. We now project our full year average share count will be just over 315 million shares. Offsetting these EPS increases is the additional interest for the remainder of the year for the debt issuance that closed in February. Netting these changes together, we now expect our EPS for the year will be $0.05 higher than we guided in January to a new range of $10.85 to $11.15 per share.

On Chart 10, we provide our sales outlook by business area for the year with no change from the outlook we provided in January. Chart 11 shows our current outlook for segment operating profit compared with what we were expecting last quarter. We increased our profit outlook in four of our five business areas with Space Systems having the largest increase for the year at $30 million. The other three business areas for each increased by $10 million to $15 million and we lowered our expected full year profit for IS&GS by $20 million for the reasons we previously discussed. And the net change for the company was a $50 million increase in our segment operating profit outlook.

Finally, Chart 12 provides our summary of the quarter. We are off to a solid start for the year with our results either tracking to or exceeding our expectations for the first quarter. We remain committed to our cash deployment actions to generate returns for our stockholders and the breath and strength of our portfolio will enable us to achieve these results.

With that, we are ready for questions. Karen?

Question-and-Answer Session

Operator

Thank you. [Operator Instructions] Our first question for today comes from the line of Peter Arment from Sterne Agee.

Peter Arment

Yes. Good morning Marillyn and Bruce.

Marillyn Hewson

Good morning.

Bruce Tanner

How are you?

Peter Arment

Bruce could you, I guess give us a little – if you can give us a little more color on the – you said the $70 million adjustment or lower profit I guess accrual in IS&GS in the quarter from the international program?

Bruce Tanner

Sure. I will start and if Marillyn has something to add to this, she will surely do so. So this was a fairly good sized international program. One of our sort of commanding control entrance that we are selling internationally, this was a pretty complex system that we were developing under Iran and as we got into the actual integration of this system in country that turned out to be more complicated than we originally anticipated. We think the charge that we took in the first quarter has this effort, I will say sized appropriately for the remaining work to be done. But I think importantly, we also think that there is a greater market potential for this product once it's installed and it's showing its capabilities. So we are optimistic there is a chance for future profitable sales with this impact or with this product going forward. I think the good news in the quarter with an IS&GS is there – if there were a number of performance improvements in the rest of the portfolio, so the way I kind of think about it is we have one issue, one fairly large issue on a large program that was offset by a sort of a number of improvements across the rest of the portfolio or maybe said it differently, but for that IS&GS, we have had a very strong quarter except for that one contracts.

Marillyn Hewson

I don't have anything more to add other than just to say that the contract size is less than $500 million, so just to keep it in perspective.

Operator

Thank you. Our next question comes from the line of Rob Spingarn from Credit Suisse.

Rob Spingarn

Good morning.

Bruce Tanner

Hi Rob.

Rob Spingarn

I just wanted to follow-up on the profit side. Your margin guidance is generally below your performance in all the segments than what you saw in the first quarter, especially when you made the adjustment in IS&GS for the $70 million, so was there anything other than conservatism baked in there?

Bruce Tanner

Rob, I don't think that we have consciously tried to bake either conservatism or optimism in there. We always start every year by saying that or at least I think I do by saying that we think we have the potential as we go throughout the year to have similar levels of risk retirements and profit pickups through the year as we had in prior years. This issue that it is on the international program and IS&GS is the thing that sort of proves that that's it can sometimes go both ways there. So these are not just given, this is not just conservatism as we go throughout the rest of the year. As we look forward, I think the timing of risk events – there tend to be the back end has a few less events than we have had in the first part of the year. We also had in particular, with the Space Systems for instance, significantly higher weighted ULA equity earnings in the first quarter as compared to the whole year. I want to say, if you look at on a percentage basis, probably 45% of the equity earnings for Space Systems occurred in the first quarter and the remaining 55% or so will be spread over the next three quarters. So it's just a lot of facing. We did have a couple of – within the business areas a couple of sort of contractual or administrative settlements that happened in the first quarter that we are not expecting to materialize in the next three quarters as we sit here today.

Operator

Thank you. Our next question comes from the line of Rich Safran from Buckingham Research.

Rich Safran

Hi, good morning.

Marillyn Hewson

Good morning.

Rich Safran

Marillyn, I heard your remarks about the budget at the opening. If so, if we assume for just a moment that the FY '16 budget is above the spending caps maybe closer to the request or if OCO funds are applied, I wanted to know if you had the sense of what the priorities would be for any additional funds where there might be upside to Lockheed Martin programs, is this the kind of thing that would impact your short cycle business at IS&GS or is this long cycle business or maybe both?

Marillyn Hewson

So, first of all, I mean in terms of the budget itself, you are right, the President base budget is significantly above the Budget Control Act sequestration budget caps that were out there. And but just to remind you, those limits still remain in place from FY '16 and beyond. So it's important that Congress address that as they move forward and they took a stab at it with these solutions by increasing the OCO in order to fund some additional spending, but until they do some statutory change, that really doesn't change the sequestration that's out there. So we really need the President to consent to these – to the OCO offers that they have and he wants an increase in both defense and domestic spending cuts I mean cap, so we know that's the case.

However, back to your question about what it means for us, certainly F-35 and C-130Js are important. In fact, if you looked at what's comes through on the unfunded priorities list, there are six F-35Bs on that list coming in from the Marine Corps and another eight F-35s or Cs for the Navy that are on the unfunded priorities list. So to the extent that additional funding is found that's important. Moreover on the C-130, there are another 13 aircraft there and the KC-130J have another two aircraft. And then there is a number of other items that have additional funding that are in our portfolio as we go forward.

I would just say that in terms of long cycle versus short cycle business, it's you hit right on, I mean building an aircraft, doing a long lead funding and going through the production process, we are well over 3 years on our aircraft and when they are in development even longer than that with the F-35. And so as we get things lined up, it's as we get funded for these then that business there is just a long cycle business that will be in our portfolio, will be in our backlog and that's important. A lot of things also are related to what happens with our troops and what's going on in the various conflicts around the world and so we will just have to watch how that transpires as well as to what kind of funding that Congress and the DoD in order to address those continuing threats.

Operator

Thank you. Our next question comes from the line of Howard Rubel from Jefferies.

Howard Rubel

Hi, good morning Marillyn and Bruce and Jerry. Thank you for your remarks.

Bruce Tanner

Good morning.

Howard Rubel

Marillyn, there has been countless headlines about all the challenges the F-35 faces, some of them are history that people like to dredge up and talk about things that you have already solved in terms of problems. And then there are things that you are still wrestling with everyday, can you kind of bring us to the point where we understand how to ignore some of the bad news and how you are coping with some of these issues that still aren't where you would like them to be?

Marillyn Hewson

Great question. Thank you for that question. We are challenged with that regularly because it is the largest program with the Department of Defense and it's a complex development program, so it's challenging in that sense. And every year as you know the GAO comes out with their annual report. There is an OT&E report that comes out annually to Congress. There are a myriad of reports that are required just given the size of the program, so we take every one of those reports into account. We read them all. They are not always exactly right and I think that's just the facts of the matter. What we try to do is stay focused on performance because that's the first and foremost thing that we can do to continue to keep this program on track.

I will say from a status standpoint, if you look back at some of the technical challenges we had early on, we have solved the landing hook. We solved the helmet issues. The software programs are going well. So from that perspective, the program is maturing. The development program that we are moving through, we are 65% complete on that. And we're going to continue to ramp up the production. Manufacturing is going well. Last year, we delivered 36 aircraft from 2014 and this year we are going to deliver about 45, so you can see it ramping up. We are going to – as I mentioned earlier, the initial operating capability, IOC for the Marine Corps, is going to be happening this summer and you have heard from the Marine Corps that they are confident. We are also confident that they will meet their IOC. And so from that perspective, I think the key is to not react to every media write-up is going to say it’s largest program and it will reflect back on initial stages of the program, but if you look at – since we rebaselined the program in 2010, we have been on track with our cost and our schedule performance.

We have rolled out a blueprint for affordability jointly with the U.S. government that is driving cost down. And by the time we move into full rate production, the cost of the F-35 will be comparable or lower than a fourth generation fighter with much more capabilities. So, I would just encourage you to continue to watch us track through the ramp up of the production, the things we are doing to drive the cost down and as we continue to move through the flight test program. And as each of these services declared their initial operating capability and as we continue to rollout more and more capability to the aircraft, I think that our nation and our allies are going to be very proud to have the requirements, the national security requirements capabilities that this aircraft will provide for many decades to come.

Operator

Thank you. Our next question comes from the line of Cai Von Rumohr from Cowen & Company.

Cai Von Rumohr

Yes, thank you very much. Aeronautics, help me understand you did 11.8% margin in the first quarter with deliveries expected to get better as we go through the year on the mature programs and yet it looks like the margin goes down. And as I read your commentary, it doesn’t look like there is anything abnormal in terms of the positives, I mean there is that $25 million risk retirement, but so why don’t the aeronautics margins kind of hold near where the first quarter is for the rest of the year?

Bruce Tanner

Yes. So, Cai, I will take that one on. I think probably the biggest reason is we have got two things going on there. One, we have a pretty good size ramp obviously on the F-35 program in total as compared to the rest even with the delivery increases that you talked about. So, you have the F-35 dilution effect occurring there. I think what maybe lost a little bit in your question there is C-5 deliveries are expected to increase fairly significantly over the first quarter just in terms of quantities and that’s another program that has a lower margin than the overall aeronautics program in general. And I think the combination of those two is what we are seeing right now offsetting the higher margin we had in the first quarter. But having said that, I still think we are going to end the year at 11% or more and I do think there are – there is potential that we can do a little better than that of some of the risk retirements break a little early for us or come a little larger than we have in our current outlook.

Operator

Thank you. Our next question comes from the line of Ron Epstein from Bank of America Merrill Lynch.

Ron Epstein

Hey, good morning. Just a quick question for Bruce just a couple of details. When you look at the financials, it looks like this year if you add up your accounts receivables and inventories, divide it by sales, you are running at a little bit of a higher rate, that's 95% than you historically have. At least for recent history, recent history seems like it's been more like in the 70% to 80% range. What's driving that? What's driving that buildup in working capital?

Bruce Tanner

Yes. So, a couple of things, I think if you just look at the first quarter, Ron, we have a historically low AR at the end of the year is sort of the payment offices clean up everything, if you will, on their docket, if you will. A lot of it has to do even with the timing of when we closed the first quarter. So, I think historically, you actually do see that we usually have a spike in our accounts receivable in the first quarter, because of those two phenomenon. Inventory is growing a little bit. And in part, that's one of the elements I was trying to describe in my prepared remarks that talk about some of the contractual resolutions are contractual finalizations that we are expecting in the second half of the year. We expect to have some collections associated with those as things like our billing arrangements get finalized and the performance-based payments terms get finalized. And so we would expect to have some reduction in our inventory account going forward. At the end of the day, Ron, I think our – the spike we see in working capital in general for all elements of working capital, not just AR and inventory, we expect that, that will probably come down over the next three quarters of the year and probably end the year, not too differently than where we started the year or ended the year 2014.

Operator

Thank you. Our next question comes from the line of Jason Gursky from Citi.

Jason Gursky

Hi, good morning everyone.

Bruce Tanner

Good morning, Jason.

Jason Gursky

I just wanted to ask a question about missile defense in the marketplace there today in light of recent awards that have been going on internationally. Can you just talk a little bit about the competitive dynamics that are going on there and what you think the opportunity that is for Lockheed with the various products you have had and the contribution to Patriot, just kind of update us on the market and what the opportunities are specifically for Lockheed going forward?

Marillyn Hewson

Well, sure. I would just start by saying that it continues to be an expanding demand for missile defense in Asia-Pacific and the Middle East for our products, along the lines of the THAAD, Aegis, Aegis Assure, Patriot, and potentially MEADS as well. As we look at, for example, MEADS, I know there was an announcement today about Raytheon winning the opportunity in Poland, but we have bought Patriot or PAC-3 is part of that system – that Patriot system. So, it's an opportunity there for us as well, but we still have an opportunity in Poland that meets international and selected to participate in technical dialogue on a short range air and missile defense system called Narew in Poland and we expect to continue to be in that dialogue. And that's one that the MEADS system is the only one that offers the capability, network and integrate on a variety of air missile defense system elements, including things that are developed in Poland, their sensors, their command and control, etcetera.

And in Germany in the midst of their evaluation to make their decision on their air and missile defense system and as you know, they have invested a fair amount into the MEADS system along with Italy and the U.S. And so we expect to participate in that opportunity and we hope that they will select, meet as they move forward on their selection. Around the world though, I think there continues to be a very strong demand as you look at Aegis continues to be a demand for Aegis. Aegis Assure we stood up or are in the midst of standing up our Aegis Assure in Romania, we have another in Poland. And so that opportunity in the European theater is also important. There are discussions with – there is South Korea on both PAC-3 and ultimately on THAAD, interest in the Middle East by a number of countries on PAC-3 and THAAD. So, I think that you are going to continue to see – continue demand for our portfolio that we have a very strong set of products and capabilities in that arena that's going to continue to have a demand.

Operator

Thank you. Our next question comes from the line of Noah Poponak from Goldman Sachs.

Noah Poponak

Hi, good morning everybody.

Bruce Tanner

Good morning, Noah.

Marillyn Hewson

Good morning.

Noah Poponak

Bruce, on the debt you raised intra-quarter, it kind of looks like the interest expense you have added to your full year earnings outlook includes interest on all of that, is that true? And it looks like intra-quarter you were discussing the potential to use some of that to refi. So if you do that, is there an opportunity to later reduce the interest expense for the full year? And then beyond refi, what else are you going to do with this cash?

Bruce Tanner

Yes, good questions, Noah. So, I think the average interest rate for the – because we did it in three tranches of varying sizes, but the average interest rate is about 3.5%. So, I think to your question – your first question, I think we are just taking the 3.5% with the last 10.5 months or 9.5 months whatever it is of exposure on the debt. And that is what the interest calculation is for this year. Going forward, we did talk to you, I think on the last – not on the last call because I'd have the intra-quarter to your point, but I think in the disclosure we did for that we described that we would potentially look at taking out some near-term debt maturities that mature in 2016. We actually have sort of two tranches that happened in 2016. They worth a little less than $1 billion combined and so we would expect that and those are – one of those at least, as a fairly good sized interest has pretty – a fairly good sized interest coupon on the debt. So we would expect interest to mitigate some in 2016 as we take out that roughly $1 billion of debt with the proceeds. And then the rest of it is strictly general purpose Noah. And as I try to tee up in the earlier remarks, I do think that we could use the potential for that for additional share repurchases throughout the rest of this year and moving into 2016.

Operator

Thank you. Our next question comes from the line of Hunter Keay from Wolfe Research.

Hunter Keay

Good morning. Thanks for taking my question.

Marillyn Hewson

Good morning.

Bruce Tanner

Good morning.

Hunter Keay

So Marillyn, you talked a little bit about the – you reiterated 25% international mix over the next few years, but do you feel like maybe given an improving domestic budget environment right now, that may be that number kind of goes back to the 20% level over the next couple of years if you maybe consider that 25% going higher as maybe a function of maybe worsening domestic environment budgetary conditions, if the domestic budget environment continues to get a little better than we all thought, may be last year at this point, is the international opportunity is that still robust enough for you to get to that 25% level even if domestic is picking up better?

Marillyn Hewson

My answer to that would be yes, absolutely. I mean our backlog today is $20 billion in international backlog at the end of 2014 and that's a significant backlog for us. The quality and maturity of the portfolio and that we are selling around the world is going to continue to have a demand. And as you probably know what we talked about and I think I even said it in my remarks, over half of the orders on the F-35 are going to be the international customers in the next 5 years. So that program alone is going to continue to grow. Earlier in my comments about missile defense, continued strong demand from missile defense. And we expect countries, besides the countries that are program of record on the F-35 there are going to be others that are going to need to retire their fourth generation aircraft, so we expect other countries to want to procure the F-35. Airlift C-130s and 72 countries and the Js is going to continue to be in demand as some of those countries upgrade their airlift capability to the J. So I would say that we are going to continue to be on a path to get to 25% over the next few years and at the same time as budgets recover and defense will continue to sell within the U.S. So I think both elements of our portfolio will continue to rise. But I do expect just given the backlog and given the opportunities that we have on the international front that we will achieve the 25%.

Operator

Thank you. Our next question comes from the line of Doug Harned from Sanford Bernstein.

Doug Harned

Thank you. Good morning.

Bruce Tanner

Good morning Doug.

Doug Harned

I wanted to go back to IS&GS and I know that you have been getting more international orders, so your backlog has a larger international component and you talked about the issue you had with this one contract, could you describe the kinds of international orders you have been winning are these – do these tend to be fixed price in nature, which in theory could give you some upside in margin, but also expose you to potentially more risk, I am just interested in so how large international is becoming an IS&GS and what the opportunity and the potential risk might be there?

Bruce Tanner

And so Doug let me try to give you a little color to that. So the international content and IS&GS is growing not leaps and bounds, but it's growing from a fairly small beginning, I will say toward now I am just thinking of top of my head is probably in the maybe 10%, maybe a little less than that, something like 7% or 10% or so of the sales of IS&GS maybe a little less than that even is what our international content is. But think of that as much higher than it was say 3 years or 4 years ago, so that part of the business is growing. Almost all thinking that there is an exception to that, but I will say almost all the international work that we are doing, not just in IS&GS, but around the whole company is in fact from fixed price efforts, so there is both upside and downside risk associated with doing that which I think a lot of this is sort of doing IT work for us, that's what we are doing in Australia is not dissimilar than what we are doing with the Pentagon here in the United States, sort of aggregating a lot of the systems and making those systems, doing upgrades, making those systems perform better and doing the overall system development work for all the IT services for – in this case, the Ministry of Defense or Department of Defense in Australia.

We do a lot of cyber work internationally. We are getting – that's a growing portion of the business as the next one that we are very happy to work. I think our reputation is spreading sort of across the globe as we do work for individual countries and in some cases, individual firms within those countries that sort of gets word-of-mouth sales that happen elsewhere. We also do internationally within IS&GS, a lot of airport management or air traffic management type activities, so the things that we do with our FAA business in the United States, think of that is doing it elsewhere, but also a lot of – sort of productivity sorts of things from an airport perspective internationally. So that's probably the three big pieces. Well, I should say there is also a little bit of Intel piece, similar – not dissimilar again to what we do with our Intel customers in the United States. So probably those four pieces Doug you should think of us what we are doing internationally within IS&GS and that portion is growing pretty significantly for us from again a fairly modest start a few years ago to where it is today.

Operator

Thank you. Our next question comes from the line of Carter Copeland from Barclays.

Carter Copeland

Hey, good morning all.

Marillyn Hewson

Good morning.

Carter Copeland

Just a quick clarification on that, Bruce with that being 7% to 10% and Marillyn's comment earlier about less than $500 million, it would make that seem like that's probably the largest program in IS&GS on the international side, is that correct?

Bruce Tanner

Yes. It's - I don't know but it is the largest, Carter. But it's one of the largest that we have, one of probably a couple of that – for that size. And I was looking at some data here, I think the actual number is slightly less than

10% for IS&GS, a little more specificity than I gave Doug on the previous question.

Carter Copeland

Great. And on the aerospace margin front, you teed up on the prior call and during the quarter some potential upside, you had talked about 100 basis points on the F-35 development contract. And once that sort of got – the delays from last year worked their way through and also on the C-5 even excluding the over and aboves and I wondered you highlighted the small amount of risk retirements on F-35, but I wondered if you could just give an update on the progress on both of those?

Bruce Tanner

Yes. So probably I want to correct something, I think I heard that you say we weren't talking about development program increases, we were talking about production improvement.

Carter Copeland

Production, correct. Sorry.

Bruce Tanner

So what you saw in the first quarter and what we disclosed in earnings release was one of those risk retirements that we were expecting to happen, that's actually probably one of the larger ones that will happen throughout the rest of the year at least this planning wise, that's one of the reasons why the margins in the first quarter were in fact higher than what we expect for the rest of the year. So I think that's tracking to what I said earlier and what I had talked about the potential 100 basis point improvement in the production program year-over-year from '14 to '15, I still think is doable and on track as we sit here today. C-5, we talked about that program in the past about the potential for a step up over time. I still think that's the path that we are looking at doing in the latter part of the year. And again as you alluded to and I will make the comment, none of those considers the potential for some entitlement actions that we have relative to the over and above work that would be separate and distinct from this. This is just sort of recognizing that we are doing a better job of sort of turning out the aircraft in the short-term cycles and the like that are resulting in better performance on that contract for us.

Operator

Thank you. Our next question comes from the line of Myles Walton from Deutsche Bank.

Myles Walton

Great. Thanks and good morning. The question I had was on space and in particular the margin performance you had in the first quarter and I think you have about $125 million of headwind on ULA for the rest of the year, so I get that, but it does look like certainly the risk retirements at Orion and the government side and probably across the portfolio are better than we have seen in a while. So I am just curious usually good things follow good things, was there a certain risk retirement related to Orion and government programs? Were you reaching kind of critical milestones or is Space just looking like it's probably going to be a source of continued upside for the rest of the year? Thanks.

Bruce Tanner

Yes, so good question, Myles, you should think of Space Systems as having a couple of risk retirements that happened in the first quarter. One of them was associated with the Orion vehicle. This was actually associated with the launch we did last year as we sort of finalized the results of that in the first quarter of this year. We kind of trued up our booking position if you will for that event and that resulted in a step up associated with that event that will not repeat itself obviously in the next three quarters. We also had some – a couple of one-offs in the quarter for things like some reliability incentives that we had at least one of the contracts within Space Systems, if not another one. And that just happened to fall in the first quarter, if you will. So, we have got a pretty good increase associated with that reliability incentives and that also reflected part of the effort this quarter that won't happen going forward. I will also remind you that as you said the latter three quarters of the year we have the ULA totally different profile than what we have had last quarter. And again as I made comments earlier much lower equity earnings going forward as compared to the first quarter.

I will also remind you though that we do have what's left as sort of the restructuring costs that are not – that have not been taken, but are reflected in our operating performance and those will continue to happen in the next three quarters without the benefit of the step-ups that we took in the first quarter. So, combined I know there is a lot of moving pieces I just gave you there, but combined is that's why we look at the margins doing what they do in the next three quarters for Space Systems. What I will say though is Space Systems is performing very, very well right now. And so I look at that and say there is the potential for opportunity as we go forward every year we do have opportunity and we are performing very, very well on our government contracts and Space Systems. There is a lot of incentive-based contracts there, where if we do well we obviously get the margins associated with that, but the government gets flipside of those incentive contracts as well. And so we are performing very well there. And I think we have some potential to do even better going forward.

Operator

Thank you. Our next question comes from the line of Rob Stallard from RBC.

Rob Stallard

Thanks so much. Good morning.

Marillyn Hewson

Good morning.

Bruce Tanner

Good morning, Rob.

Rob Stallard

Bruce, I was wondering – just quick question on the book-to-bill. I was wondering if you could comment on the various trends that you are seeing there, particularly down the short cycle side and when we might see some improvement in perhaps the IS&GS book-to-bill through this year?

Bruce Tanner

Yes. So, Rob, maybe I will just give you – I thought that there might be a question on orders, so maybe I will just give you sort of a little bit of a full overview of where we sit from orders perspective. Sort of it, it has been our history at least the last few years, we are going to be significantly back-end weighted in our orders for the year. And as we sit here today, it wouldn't surprise me if there is probably 65% or so of the orders that we are expecting to have for the year will actually materialize in the second half of the year. And you should think about – we have got quite a few big ticket items to sort of keep your eye on, so we have got the bomber awards some time in the summer of this year. We have got finalization of the C-130J multiyear. We have got the next production lot, Lot 9 of the F-35 program occurring. And with that – and it's just a lot of contracts, but they add up to a lot of dollars individually – or collectively, they add up to a lot of dollars, just a whole lot the various F-35 sustainment contracts and long lead contracts for future LRIPs. And you combine that with a lot of the international orders we are looking at for THAAD and PAC-3, for instance and you see there is some pretty big chunky sized orders coming in the next three months, but more weighted with second half of the year. I didn't mention JLTV, but that's obviously another critical strategic win. So, the big strategic items we are looking for from a competitive perspective this year are the bomber award and JLTV.

To your specific question on IS&GS, I think we are going to – last year, we actually grew backlog in IS&GS which was the first time we have done that for a while. As we look forward, I think the IS&GS orders are probably sequentially going to grow and get close to the sales value, but probably not as much as the sales for the year, so we will probably have some reduction in our backlog in IS&GS as we close the year. In part because we did recall, we did get so many orders in 2014 that were sort of multi-year orders that won't be replicated, if you will in 2015. Just – and maybe one last comment, we still think as we sit here today and we said this for a couple of years in a row, we do think we are on a track to get back similar to where we started at the end of last year about $80 plus million level for total backlog for the corporation.

Operator

Thank you. Our next question comes from the line of Sam Pearlstein from Wells Fargo.

Sam Pearlstein

Good morning. Bruce, I was wondering if you could talk a little more, you talked about the phasing just now of the orders you have done it on the cash flow, can you talk a little bit about maybe the earnings as we go through the year. And then also the buyback activity should it be fairly ratable at this $600 million and related to that, you mentioned the options exercise, is there a point where we start to see the share count really move down when we get to the other side of those options, is that this year?

Bruce Tanner

Yes. Of course, we will try to hit all of those for you Sam. So overall margins, I think we had a bit of a spike, probably not unlike what we did last year, frankly as the corporation, I think we came down from a pretty high first quarter and we dropped the next 3 quarters. A lot of that's just the phasing and timing of when we get some of our awards and some of our incentives on our contracts across all of the business areas. So I would expect margins would be probably lower over the next three quarters. I think the second and third quarters will probably be similar to each other whereas the fourth we could have a little bit higher margin. So thinking of the second and third, probably running in the low-11s and maybe as we sit here today, with the timing of our risk retirements, the fourth quarter could actually be in sort of the high-11s going forward, that's sort of how we see it as we sit here today.

And again, as I said on an earlier comment, if we pull some of those to the left or do them or do higher adjustments than we had in our plan, obviously we could get better than that or worse than that. So repo, second part of your question, the repo activity, we did $600 million in the first quarter. We would expect to do more in the second quarter. If I was to predict, I would say it's going to be maybe not twice as much as we did in the first quarter, but it wouldn't surprise me if we did as much as $1 billion or so in the second quarter and then I think we will trail off maybe a little bit in the third and fourth, that's as we sit here today. And a lot of that's based on sort of the cash that was available on the balance sheet in the first quarter versus what we have got after the debt issuance in February that enables us to do that, that sort of enhanced repos for the rest of the year. There are about 900,000 options that were exercised in the first quarter. We started the year with about a little more than 6 million options outstanding. As I said earlier in the prepared remarks, we were expecting options actually to have a higher level of exercising than we experienced in the first quarter. So we are watching that closely and last year, I think we did 3.7 million or 3.4 million shares, that's we are kind of expecting in our guidance right now about 3 million for the year, so that will be the toggle switch as to whether or not we do higher or lower than that.

The last thing I will say on that, on the option exercise is you asked the question about would we expect to see sort of a step function decrease. And I think the answer is yes to that. Sam as soon as the options have been exercised, there are no options replenishing those if you will, so this is a diminishing number in our dilution equation that once those 5 million options are left or exercised, they will not be replicated by a like number of options going forward. So in the way, I usually like to describe it as every single dollar of share repurchase spent once we are at that point, where we no longer have options we will have a greater chance of actually reducing the share count of the corporation.

Jerry Kircher

Karen, I think we have got time for one more question.

Operator

Certainly. Our final question for today comes from the line of George Shapiro from Shapiro Research.

George Shapiro

Yes, good morning.

Marillyn Hewson

Good morning.

George Shapiro

Marillyn, I just wanted to ask your strategy in the cyber world, you obviously saw Raytheon make a big acquisition yesterday in the commercial cyber world. You are a big player in this area, if you can just kind of lay out what your strategy is?

Marillyn Hewson

Sure. I will be happy to. I mean, it is an important area for us as a company. For the past 20 years consecutively, we have been the largest IT provider for the U.S. government and working for all of the cabinet agencies on a range of IT as well as cyber security. I like the portfolio that we have around cyber security. We have a multi-decade track record with encryption, with data security solutions. And we centralized all of our cyber security in the IS&GS organization. And so and our go-to-market strategy both within the U.S. government as well as commercial, that's where we are moving forward. We see incremental growth there and we rolled out and even internationally, as Bruce commented earlier, we have a cyber security intelligence center in Farnborough in the UK. We have another one in Canberra, Australia. We have our own here in the U.S. So, it is absolutely an important growth area for us. And I think what's key to us is that we have been doing cyber security long before they ever coined the term cyber security. So, it's a very important growth area for us and one that we expect to continue to excel in.

Jerry Kircher

I think that wraps it up for the time. Let me turn it over to Marillyn for final comments.

Marillyn Hewson

Well, let me just conclude today, I just want to reiterate that the corporation has had another solid quarter and it's well positioned to deliver even higher value to customers and stockholders in 2015. The ongoing execution of our employees coupled with our growing cash generation, our strong backlog of work and a solid balance sheet will continue to prevail our corporation forward in 2015 and beyond. So, thanks again for joining us today. We look forward to speaking with you in the next earnings call in July. Karen, that concludes our call today.