Good day, and welcome, everyone to the Lockheed Martin Second Quarter 2016 Earnings Results Conference Call. Today's call is being recorded.

At this time, for opening remarks and introductions, I would like to turn the call over to Mr. Jerry Kircher, Vice President of Investor Relations. Please go ahead, sir.

Jerry F. Kircher - Vice President-Investor Relations

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

Statements made in today's call that are not historical 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 - Chairman, President & Chief Executive Officer

Thanks, Jerry. Good morning, everyone, and thank you for joining us on the call today. We are pleased to have you with us as we review second quarter results and our increased financial outlook for 2016.

As today's release details, we had a very strong quarter operationally and financially. The corporation continued to track towards another year of strong financial results, while returning value to stockholders and delivering critical solutions to customers. I want to highlight a few key items in the quarter, including the status of the strategic transaction in which our Information Systems & Global Solutions business will be separated from Lockheed Martin and combined with Leidos. And I'll share some noteworthy operational achievements in our business areas.

Turning to the summary financials, our team continue to deliver broad-based results across the corporation, the second quarter numbers exceeding all of our internal plans. This strong year-to-date performance enabled us to increase full-year 2016 guidance for sales, segment operating profit, earnings per share, and cash from operations. As a reminder the guidance continues to assume inclusion of full-year 2016 financial results from the IS&GS business. If the divestiture of IS&GS is completed in the third quarter as currently anticipated, we will revise our 2016 financial outlook during our call with you in October.

Switching to IS&GS and the status of its combination with Leidos, significant progress towards transaction closure continues to be achieved. We commenced our exchange offer on Monday of last week. Also last week, the Competition and Markets Authority in the United Kingdom concluded its review, satisfying another condition to closing. As we outlined on our press release last week, announcing the start of the exchange period, the offer provides Lockheed Martin stockholders the opportunity to exchange their shares of Lockheed Martin for shares of stock in a Lockheed Martin subsidiary, which then become shares of Leidos common stock upon completion of the transaction.

As you are aware, the combination of IS&GS with Leidos is structured as a tax-efficient Reverse Morris Trust transaction. We will then retire the series of Lockheed Martin stock exchanged, achieving a significant reduction in our outstanding share count. The transaction remains subject to customary closing conditions and closing is currently scheduled for August 16.

Switching to operational highlights, I'll start with some key accomplishments and events on the F-35 Joint Strike Fighter program. Overall the program continued to achieve good progress across the multiple fronts of winding down development activities, ramping up production rate and sustainment activities and securing customer support and demand. On the development program, key events this quarter included surpassing 60,000 flight hours of the F-35 fleet, demonstrating the increasing level of flight operations and maturity of the aircraft. We are also achieving increased stability in the software on the aircraft and in the ground support equipment.

We continue to make strides in software development on the aircraft and in the Autonomic Logistics Information System, known as ALIS, that is used to maintain the F-35 planes. Evidence of this progress was demonstrated last month at Mountain Home Air Base in Idaho, where F-35 fighters were deployed to a remote site to test aircraft performance and mission availability, using the latest version of the maturing software.

During this deployment, the aircraft successfully cleared 88 of 88 sorties, while also achieving 100% on-time performance of the sorties. Additionally, the aircraft achieved zero avionic shutdowns on the ground or in flight due to any software stability issues. The deployment met all of the customer's tactical objectives and proved that the aircraft can successfully operate at remote locations away from its home base. These successful series of tests are key milestones in preparation of the F-35 CTOL fleet to achieve initial operational capability for the U.S. Air Force later this year.

During the deployment test at the Mountain Home base, the F-35 had the opportunity to engage with frontline legacy aircraft and performed exceptionally well in mock combat engagements. The tremendous technological leap in capabilities that the F-35 provides are being demonstrated on a daily basis to a growing number of domestic and international customers as the aircraft is fielded at additional sites.

With the future price of an F-35 estimated to approach the price of a legacy fighter, the unmatched capability of fifth-generation stealth provided by the Joint Strike Fighter becomes even more compelling to customers as they recapitalize their fighter fleets. Looking at the production activity on the program, progress continues to be made in ramping up the rate of production and reducing the cost of the aircraft.

On production, we are on track to increase our deliveries to 53 aircraft this year and have delivered approximately 180 aircraft since program inception. In the area of cost reductions, we continue to make significant progress on our previously announced blueprint for affordability, shared commitment between the government and industry.

To build upon that success, we announced two additional cost reduction initiatives last week at Farnborough. The first action is a two-year extension of our cost savings investment that is designed to achieve lifecycle savings of more than $4 billion over the remaining production run of aircraft.

Additionally, we also announced an initiative over the next couple of years to reduce sustainment costs by 10%. This action is expected to achieve $1 billion in savings for the five-year period, and includes projects such as spare parts block buys and establishing ALIS regional sustainment centers.

Turning to customer support and demand for the F-35, key milestones this past quarter on the domestic side include revalidation to Congress by the Department of Defense of the critical and unchanged procurement requirement to replace legacy aircraft with 2,443 JSF fighters for the U.S. Air Force, Navy and Marines. Internationally, support remains strong and growing with key events that included selection of the F-35 by the Danish Parliament as their next generation fighter with a procurement of 27 aircraft; rollout of the first F-35A for Israel at our Fort Worth facility and the arrival of the first two F-35A fighters into the Netherlands. I was able to see firsthand the growing international interest and support of the F-35 earlier this month, when I had the opportunity to attend both the Royal International Air Tattoo and Farnborough air shows in the United Kingdom.

Customers and attendees were able to see up close the revolutionary capabilities of both CTOL and STOVL F-35 aircraft at the air shows as they performed their aerial maneuvers. This marked the debut of the F-35 at major international air shows, demonstrating the increasing maturity and progress on the program.

We are honored to partner with international F-35 customers to strengthen the security relationships among our nation and allies, as we collectively field this next generation fighter for decades to come.

Turning to other areas in the corporation, a noteworthy accomplishment was achieved on our Sikorsky CH-53K King Stallion helicopter program for the U.S. Marine Corps. The test helicopters on the development program continued to progress through a series of increasing payload lift weights to validate capabilities. Recently, the aircraft successfully lifted a 27,000 pound external load, satisfying the contractual requirement for maximum lift weight. With more than triple the payload of the predecessor CH-53E, the new helicopter can accommodate a range of missions. The CH-53K can execute heavy lift missions more effectively and safely, in day and night and all weather conditions using its modern glass cockpit.

To date, we have delivered three CH-53K helicopters on the development program that are enabling testing to move ahead and support the service's goal to achieve initial operational capability planned in 2019. Providing this enhanced capability is essential to our fighters and the Department of Defense program of record continues to project procurement of 200 CH-53K aircraft to replace aging legacy helicopters. The CH-53K is also generating growing interest from multiple countries, in addition to that in the United States and offers opportunities to expand production levels beyond the quantities required on the Marine Corps program.

I will conclude my remarks by offering my congratulations to our Space Systems team for their flawless support of NASA's interplanetary mission to insert the Juno spacecraft into orbit around Jupiter. The Juno spacecraft was designed and constructed by our space personnel in Colorado and has been operated as a joint team with NASA. After launch in August 2011, the spacecraft traveled 1.8 billion miles to Jupiter, at speeds of up to 165,000 miles per hour for almost five years, before successfully settling into orbit on July 4. Juno will spend nearly two years orbiting the planet, while studying the structure, origin, atmosphere and magnetosphere of Jupiter for NASA. The successful orbit insertion mission exemplifies the unmatched capability of our corporation in making the impossible, possible for our customers.

There were no second chances for this orbital insertion and our spacecraft and teammates performed flawlessly in achieving mission success.

Before turning the call over to Bruce, I want to offer my appreciation and thanks to our IS&GS team. Their dedication and continued focus on mission execution and our customers during this extended transitional phase have been superb. With the upcoming closure of the transaction with Leidos, I am certain that the IS&GS efforts have made the business even stronger and helped position the new enterprise to generate value for shareholders and opportunities for employees as they move forward.

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

Bruce L. Tanner - Chief Financial Officer & Executive Vice President

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 three and an overview of our results for the quarter.

Sales for the quarter were $12.9 billion, well ahead of our expectations. Segment operating profit was also higher than expected at $1.4 billion, resulting in earnings per share of $3.32 in the quarter and we'll discuss each of these metrics in the coming charts.

We generated $1.5 billion in cash from operations and returned $1 billion of cash to our stockholders in the quarter. And as with last quarter, we are increasing our outlook for sales, operating profit, earnings per share and cash from operations. All in all, we had a strong quarter and are well-positioned to the first half of the year to achieve our outlook.

On chart four, we compare our sales and segment operating profit this quarter versus the second quarter of 2015. Sales were higher by $1.3 billion or 11% this year than last year, driven by the inclusion of Sikorsky in the results of MST for about $1.2 billion and nearly $250 million in growth at Aeronautics driven by $400 million higher F-35 volume which more than offset two fewer C-5 deliveries in the quarter compared to last year.

Segment operating profit was $24 million higher than last year, with the growth coming from the volume at Aeronautics and significantly higher profit in IS&GS and Space Systems. These increases more than offset the effects of purchase accounting adjustments and transaction cost associated with the acquisition of Sikorsky as well as the expected reduction of margin at Missiles and Fire Control.

On chart five, we'll discuss our earnings per share in the quarter. Our EPS in the quarter was $3.32, which represents about a 13% increase over the EPS in the second quarter of last year. This year benefited from strong operational performance, a higher FAS/CAS adjustment and a $0.04 benefit from the adoption of a new accounting standard as discussed in our earnings release.

If you'll turn to chart six, we review our cash from operations in the quarter. Cash generated in the quarter was almost $1.5 billion, $200 million more than in the second quarter of last year. This is particularly noteworthy given that we expected to recover a significant amount of cash associated with the completion of negotiations on F-35 LRIPs 9 and 10 by now. Strong cash generation in each of the other core business areas beyond Aeronautics, including a large international receipt by Sikorsky, helped to offset the F-35 shortfall. And while we expect to recover that shortfall soon, if additional funding is not received, the investment level will grow dramatically during the coming months.

Turning to chart seven, you can see the significant amount of cash returned to our stockholders in the quarter. With just over $1 billion returned to stockholders evenly split between dividends and share repurchases, we returned over 80% of free cash flow in the quarter.

Chart eight provides an update to our current outlook for the year. As a result of the strong performance in the quarter and prospects for the remainder of the year, we're increasing our sales outlook by $400 million and our segment operating profit outlook by $125 million. We'll provide additional insight into these improvements in the next two charts.

We also increased our outlook for earnings per share by $0.65, and we'll provide more detail into that increase in a few charts. And we're increasing our cash from operations outlook by $100 million. This obviously assumes that we receive additional at F-35 funding, as we've already discussed. And as a reminder, our guidance continues to assume the inclusion of full-year 2016 financial results from the IS&GS business.

Chart nine provides the updated sales outlook by business area. We increased our sales outlook by $400 million, $350 million in Aeronautics due primarily to higher than planned F-35 volume, and $50 million in Space Systems, reflecting the stronger start to the year than we anticipated.

On chart ten, we show the changes to our segment operating profit outlook by business area. We increased our profit outlook by $125 million, with $60 million of that increase coming from IS&GS as a result of its strong first-half performance. Aeronautics increased by $40 million driven by the higher sales volume, and Space Systems increased by $25 million, reflecting its better than planned performance to date.

Moving to chart 11, we have a reconciliation of our current earnings per share outlook compared with the first quarter. The $125 million increase in segment operating profit increases our outlook by $0.25. The newly adopted accounting standard for the treatment of equity-based compensation that we described in our earnings release increased 2016 EPS by $0.45. This change in accounting is reflected as if it had been in place from the beginning of the year.

As a result, our year-to-date EPS includes a benefit of $0.37, $0.33 from the first quarter when the majority of our equity-based compensation vested. The remaining two quarters of the year are anticipated to receive similar benefits of $0.04 per quarter, totaling to the $0.45 increase for the year. A number of minor other changes in the quarter amounted to a $0.05 reduction to EPS, and combined, these changes increased our EPS outlook by $0.65 for the year.

On chart 12, we have a reminder of several key financial impacts that we expect when the IS&GS Reverse Morris Trust transaction closes. We'll receive a special cash payment of $1.8 billion. At current trading prices, we would expect to reduce our common shares outstanding by about 10 million shares, though this is obviously subject to change as both Lockheed Martin and Leidos stock prices fluctuate during the exchange period. And we would expect to have a significant book gain when the deal closes. In addition to the deal closure in the third quarter, we expect to have a number of other significant events occur in the quarter as well.

Chart 13 highlights these upcoming financial events. Obviously, the first significant event we are expecting is the IS&GS transaction closure. The year-to-date results of IS&GS through closure will be moved to discontinued operations, as will the book gain that we discussed on the prior chart. We also expect to have a net pension gain upon closure associated with the departure of IS&GS employees. This pension gain will be recorded in discontinued operations as well. Corporate cost allocated to IS&GS up to the date of closure will be moved from IS&GS' results and reflected as other unallocated cost in continuing operations. Importantly, there is no economic impact as a result of this cost reclassification, and we will be filing pro forma financials.

Next, we expect to close on the F-35 LRIP 9 and 10 contracts, and recover the significant operating cash tied to those negotiations. We also expect to increase our ownership and obtain control of a joint venture within Space Systems to manage the atomic weapons establishment in the UK. A book gain will be recognized in our operating results upon closure of the transaction.

Going forward, we will fully consolidate AWE's financials and continue to report its operating results in our Space Systems segment. Then, we expect to finalize our Sikorsky purchase accounting adjustments next quarter. And lastly, we'll provide our trend information for 2017, including an updated discount rate projection and its impact on our expected FAS/CAS adjustment. So, you can see that we anticipate a number of moving pieces in the quarter, some of which are individually significant, but collectively will be quite significant. We'll provide updated guidance for all these events during our next earnings call in October.

Finally, on chart 14, we have our summary. We had a strong quarter, and that led to increases in our outlook. The IS&GS exchange offer has begun, which places us on the path to close the transaction in the middle of August, and we remain focused on providing outstanding products and services to our customers, and strong returns to our stockholders.

With that, we're ready for your questions. Kat?

Question-and-Answer Session

Operator

Thank you. In the interest of time, we are limiting you to one question. Please return to the queue for any follow-up questions. At this time, we're opening our lines for questions. Our first question comes from line of Hunter Keay with Wolfe Research. Your line is open.

Hunter K. Keay - Wolfe Research LLC

Thank you. Good morning, guys.

Bruce L. Tanner - Chief Financial Officer & Executive Vice President

Good morning.

Hunter K. Keay - Wolfe Research LLC

I realize it's maybe a little bit early to ask this question, but can you help us think about the work statement that you have with Turkey as it relates to the F-35 in the context of maybe some of the sustainment? And if you want to talk about any sort of longer-term implications from some of the recent activities there as it relates to the F-35, that would be helpful. Thanks so much.

Marillyn A. Hewson - Chairman, President & Chief Executive Officer

Sure, I'll take that question and, Bruce, if you have anything you want to add, (22:30) do that. I think if you look at Turkey, I know there's been a lot of churn in Turkey here recently, but it still remains a very valued NATO partner for us, a NATO ally, and it's got – it's an essential security partner in that region for the United States and for our allies. So we look forward to continue our business relationship there and across the number of programs that we have.

We have not seen any indication that it will impact the F-35 or any of their other programs. And so, we'll continue to assess the situation and make sure that we'll share with you if there's any impact on our business. Their plan is to procure 100 F-35s, so they're a very important partner in that program. Bruce, anything you want to add?

Bruce L. Tanner - Chief Financial Officer & Executive Vice President

Yeah. The only thing I would add, Hunter, is we've got a long, long history with Turkey. We've worked with them since the pretty early days of the F-16 program. We've actually built F-16s in Turkey. As you know and the heart of your question, we're also doing parts of the F-35 at TUSAS Aerospace Industries in Turkey. That relationship has been successful. As you said, it's probably early to call what the grand implications are, but they've been, as Marillyn said, a trusted partner with Lockheed Martin for quite some time, and we hope that's the case in the future, obviously.

Operator

Thank you. Our next question comes from the line of Pete Skibitski with Drexel Hamilton. Your line is open.

Peter John Skibitski - Drexel Hamilton LLC

Hey. Good morning, guys. Nice quarter.

Bruce L. Tanner - Chief Financial Officer & Executive Vice President

Good morning. Thank you, Pete.

Marillyn A. Hewson - Chairman, President & Chief Executive Officer

Thank you.

Peter John Skibitski - Drexel Hamilton LLC

The F-35, the LRIP 9, 10 contract, you talked about the investment level growing dramatically in the coming months if it doesn't get signed, I think. Can you size that for us? And what's your sense of how close you are to the contract getting signed and are you definitely going to cash fund it if it doesn't close?

Bruce L. Tanner - Chief Financial Officer & Executive Vice President

Yeah. So, let me give you just a little bit of color. It's a good question, Pete. And so, the current level, I think we disclosed in the earnings release. We've got nearly $1 billion or so that we're funding on the program, and that's a decision that we made to do that for whatever reason the U.S. Government has not decided to put funds that are authorized and appropriated to fund Lockheed Martin and our subcontractor efforts on the contracts.

So, we've been – we made the decision at the time that we were going to not allow a stop on the program and cause a disruption on the program, particularly in our supply base that's – since that's where most of the work is being done at this time on the F-35 LRIP 9 and 10 contracts. So, we've been funding that for a while. We continue to ask for funding recovery from the U.S. Government. To this point, they have not funded us. At some point in the future, because of the growth that we see over the next few months, and you should think of this literally growing, Pete, in the $400 million to $500 million per month sorts of levels, we will not be able to sustain that. So that if we don't either get funding through a funding mechanism such as a Yucca (25:46) funding item or we definitize the contracts, we will not be able to continue and have that level of cash outflow as a corporation, we simply don't have that capacity. The Pentagon clearly knows that situation, and I'm optimistic that we're going to get cash soon.

Operator

Thank you. Our next question comes from the line of Rich Safran with Buckingham Research. Your line is open.

Richard T. Safran - The Buckingham Research Group, Inc.

Marillyn, Bruce, Jerry, good morning.

Bruce L. Tanner - Chief Financial Officer & Executive Vice President

Good morning.

Jerry F. Kircher - Vice President-Investor Relations

Hi, Rich.

Marillyn A. Hewson - Chairman, President & Chief Executive Officer

Good morning.

Richard T. Safran - The Buckingham Research Group, Inc.

I know I usually ask the question about programs, but today, I have one on pension income and cash funding requirements. Now, if you would – relative to where rates were in – are in – were in 2015, I want to know if you could maybe discuss what you expect for 2017 for FAS/CAS income. Also, can you give us maybe your best estimate regarding whether or not you're going to have a cash contribution to pension next year? If so, how much? Maybe you could give us a range on that. Anything you could give would be helpful.

Bruce L. Tanner - Chief Financial Officer & Executive Vice President

Yeah, I'll take that one, Rich. Thanks for the question. So, we're probably a little early to be talking about 2017. I think it feels a little early to be talking about 2017, but I think it's a fair question given all the changes that have happened in the interest rate environment here recently, particularly after the Brexit situation. And I think what our 10-year treasury is going for, 1.4% or thereabouts, so dramatic reduction from the start of the year to now. I think we ended the year at a discount rate of about 4 3/8% or 4.375%. If we were to strike a line on the sand right now, it's probably 100 basis points lower than that. You tell me whether you think it's going to increase between now and the end of the year or not, but if it did not, every 25 basis points change in the discount rate from where we ended last year is worth about $125 million delta to FAS expense. So that's a pretty significant reduction in the FAS next year. Our asset returns, you didn't ask about those, but that's the other component in the mix. The asset returns are actually tracking pretty nicely towards an 8% return. We've had a nice lift in the equity markets, particularly domestically here recently that it helped with that situation. So, if I were to predict, again, kind of striking the line in the sand, our current FAS/CAS in 2016 is roughly, what, $975 million or so of income. Looking forward and just carrying those impacts into 2017 that I just described, 2017 would probably be $350 million, maybe $400 million lower than 2016 still income from FAS/CAS, if you will, but not as much income as what we've been expecting and talking about previously.

As to your cash funding question, there is no impact next year at all associated with the discount rate change. I mean, ERISA is far more – ERISA, which requires the funding levels for our pension trust, is far more sensitive to asset returns than the discount rate changes. FAS is sort of a instantaneous discount rate impact, where as ERISA is spread over time. So we wouldn't expect any change whatsoever in the funding requirements in 2017, still zero.

Operator

Thank you. Our next question comes from the line of Joe DeNardi with Stifel. Your line is open.

Joseph DeNardi - Stifel, Nicolaus & Co., Inc.

Yeah, thanks. Good morning. Bruce, I think you talked the last quarter about 2018 pension contributions. And apologies for asking a question that's so far out in the future, but you said that you think you can fill most or if not, all of that gap. I'm wondering if you could provide a little bit more detail about – of the $1.5 billion in contribution, what's the cash tax benefit and then what are some of the other areas you see as helping you guys fill that gap?

Bruce L. Tanner - Chief Financial Officer & Executive Vice President

Yeah. Thanks, Joe. So I actually plan to give a little more insight into the 2018 numbers probably in the October call, but let me take a shot at it now just because you asked the question. So, we have said that 2017, we talked about being the last of the three-year, what we call pension funding holiday that we announced, I guess, at the beginning of 2015. As Rich asked in his question about cash funding, we don't see that changing in 2017. In the previous quarters, I did talk about 2018 having a required pension contribution, and obviously, that's still the case. However, what I was trying to convey – and the number you threw out, about $1.5 billion, it's floating around there maybe a little bit higher now.

But what I was trying to convey on previous calls and what I'll try to convey on this call is you shouldn't think of sort of the current level of operating cash dropping by the full amount of pension funding in 2018, and that's really for a couple of reasons. One is we expect to get much stronger cash flows from Sikorsky in 2018 versus what we're seeing today. We expect to have higher cash flow from F-35 than we're seeing today. And then lastly, as you described in your question, we also – we'll get a tax benefit associated with the pension cash contribution in 2018. So think of that as sort of 65% simplistically of the cash contribution is what will be a hit to operating cash in that year, if you will.

Operator

Thank you. Our next question comes from the line of Sam Pearlstein with Wells Fargo. Your line is open.

Samuel J. Pearlstein - Wells Fargo Securities LLC

Good morning.

Marillyn A. Hewson - Chairman, President & Chief Executive Officer

Good morning.

Bruce L. Tanner - Chief Financial Officer & Executive Vice President

Good morning, Sam.

Samuel J. Pearlstein - Wells Fargo Securities LLC

Hi. I was just wondering if you could talk a little bit more philosophically just about capital allocation and share buyback. And I know you have a target of 300 million shares – or less than 300 million shares outstanding, but just trying to think about where the stocks multiple is now and just trying to think about how you factor that into what you do with your capital and whether that makes other alternatives more attractive than repurchasing shares.

Bruce L. Tanner - Chief Financial Officer & Executive Vice President

Yeah. Let me take a shot at that, Sam. So, it's a great question as far as capital allocation plans. We still feel strongly about the dividend, capital allocations that we provided to shareholders. We have – if you just look at the composition of our shareholder base, it's probably, I don't remember if 30%, 35%. I'm looking at Jerry, I say it is 30%, 35% of our investor base is sort of income base. So, that's a pretty significant element of our ownership that is driven, in fact, by the dividend yield. So, that's an important aspect of capital allocation going forward. I always say that I think the best indication of what we'll do there is sort of the track record we've had in the last few years or even a decade or more relative to dividend contributions. We still have some options that have yet to be exercised. The option exercise has actually slowed down quite a bit. If I remember, Sam, you've been following us long enough years ago, we had a lot of dilution as a result of options being exercised, that level has come down quite a bit, but there's still a backlog of options out there that as those do get exercised, we will clearly do share repurchases to offset that dilution. We will do share repurchases to offset dilution from the equity compensation as well.

And then from that point, Sam, as usual, and this probably will not be the most satisfying answer you'll get, but as usual, it sort of depends on what's available in terms of capital allocation at that time, including other opportunities to invest in programs, acquisitions, that sort of thing. The one thing that probably doesn't make a whole lot of sense at least at this point is to let it just sit sort of idly on the balance sheet, making as little interest as, in fact, it does. I'll remind you, and I know you know this, Sam, but the RMT transaction will reduce share count pretty significantly on its own, probably somewhere between 9 million shares and 10 million shares at sort of current trading. And on top of that, we get the $1.8 billion special payment, as I talked about. And lacking a more pressing or – what's the word I'm looking for...

Marillyn A. Hewson - Chairman, President & Chief Executive Officer

Opportunistic.

Bruce L. Tanner - Chief Financial Officer & Executive Vice President

Opportunistic. That's good work, Marillyn. Opportunistic use of that $1.8 billion, I would think a good chunk of that would probably go towards share repurchases.

Operator

Thank you. Our next question comes from the line of Doug Harned with Bernstein. Your line is open.

Doug Stuart Harned - Sanford C. Bernstein & Co. LLC

Thank you. Good morning.

Bruce L. Tanner - Chief Financial Officer & Executive Vice President

Good morning.

Doug Stuart Harned - Sanford C. Bernstein & Co. LLC

I'm interested, Bruce said when – and you clearly had a very good quarter, and you said that it was a surprise to you all, I think, that the sales and your profitability were up as high as they were. Could you talk a little bit about that? Because if I look forward for the rest of the year, are these – is the surprise you had something that suggests your ongoing performance may actually be better perhaps than you've been expecting? And the guidance change doesn't really suggest that. So I'm just wondering what you took away from the quarter and what that means for the longer term.

Bruce L. Tanner - Chief Financial Officer & Executive Vice President

Yeah, it's a good question, Doug. Look, I'm very happy with the first half of the year. And I don't know that if (36:08) that, but I used the word surprise, I'll say we were pleasantly higher than expected or higher than planned for a couple of items, including, for instance, the ULA equity earnings that we got in the quarter. Some of this was sort of fortuitous in terms of the mix of launch vehicles, also the pricing of the launch vehicles that we had in the quarter for ULA. So, for instance, we had an Atlas or – excuse me, a Delta Heavy launch, which is the most expensive launch vehicle that ULA produces, went off in the second quarter, that helped the earnings in the second quarter.

Things like that, again, for the first half of the year, all helped us. You were quizzing a little bit about while that didn't necessarily translate into the full-year, I'll say we kind of gave the first half performance and the outlook for the year, and we definitely have the opportunities that I think you're alluding to, Doug, in the second half of the year, but we have to make those happen. And sometimes things don't work out as planned, and that's probably the reason that we provided the guidance that we did. But nothing taken away from – we feel very, very good and pleased with the first half performance of the year.

Operator

Thank you. Our next question comes from the line of Myles Walton with Deutsche Bank. Your line is open.

Myles Alexander Walton - Deutsche Bank Securities, Inc.

Thanks. Maybe just a follow-up on the – with a little more specificity on Aeronautics. I'm curious why the second half EBIT implied in the guidance is flat to maybe even down a touch versus the first half on higher volume, and then I think you're also recovering the restructuring expenses you had in the first quarter. So is there mix, is there something else maybe, Bruce, that you can help us explain why Aeronautics isn't going to outperform that guidance?

Bruce L. Tanner - Chief Financial Officer & Executive Vice President

Yes. Good question, Myles. So, look, I kind of answered the question from Doug. I'd like to think that we have sort of, as I said in previous calls, the same sort of opportunities. If I have a good second half as we have in the first half, the one probably most notable change from first half to second half is the fact that we had some F-35 production step-ups in the first half of the year, particularly on sort of the winding down of LRIP 7 aircraft deliveries and a little bit of step-up on LRIP 8, excuse me, as we go into a higher ramp rate there.

We don't currently have plans for F-35 production step-ups for the rest – or for the second half of the year, and so that's one of the things that will cause the second half of the year to look a little wider probably than the first half of the year. And then secondly, the volume level of F-35, as I alluded to, and the reason for the change in our guidance for the year is really significant – is really expected to be higher in the second half, and that has that dilutive effect on the overall margins of Aeronautics that I talked about in the past. So, those two reasons probably both netted to F-35, one was the step-ups that occurred in the first-half; and secondly, excuse me, is just the volume in the second-half.

Operator

Thank you. Our next question comes from the line of Howard Rubel with Jefferies. Your line is open.

Howard Alan Rubel - Jefferies LLC

Thank you very much. Marillyn, you put one of your top managers at Sikorsky to run the business. Could you give us sort of a six-month read on where you are and how it's going? I mean, it looks to me like it's a little more expensive out of the box than one would have first thought.

Marillyn A. Hewson - Chairman, President & Chief Executive Officer

Well, you're right about putting one of our top folks there. We have Dan Schultz who run large business areas for businesses for us in the past and also is a helicopter pilot out of the Marine Corps, so he knows the business extremely well and he's doing a great job there. I'll tell you, I'm really excited about a couple of things, Howard, that we've seen in the past six months. First off, we're tracking to what we had planned.

I mean, well, from your perspective, maybe different, but frankly, we're right on plan with what we track. But what I'm excited about is some of the revenue synergies that we see just by getting the integration process well underway and getting our teams together. For example, we were – I was at the Farnborough Airshow, as I mentioned earlier, and we showcased an armed BLACK HAWK helicopter that's taking weapons systems and sensors and things from our Missiles and Fire Control business, combining it with the platform that's in Mission Systems and Training, Sikorsky business, and showcasing that on – at our satellite area in Farnborough. And we had tremendous amount of interest in it. A lot of customers are now following up with us on – and interest there, so that's just one example. We've got many other examples where our teams are getting together and we see a chance to do just what we thought when we purchased Sikorsky, and that is to not only get the cost synergies of bringing that element into our business, but also – but more importantly, to get the revenue synergies and get the growth moving forward on it. So, we're on track, we've talked before in this call about our commercial element Sikorsky and the oil and gas price pressures on that business, but we've been very frank about where we stand on that, and based on what our outlook was and what we set for the year, we're right on track with that as well.

Bruce L. Tanner - Chief Financial Officer & Executive Vice President

Hey, Marillyn – or, Howard, just to add maybe a little bit to what Marillyn said relative to the armed BLACK HAWK, only because I think it's an interesting little tidbit there. So you should think of this as essentially taking a utility helicopter platform and essentially transitioning it into an attack platform. The interesting thing from the way the design was conceived and the way it will be sold internationally, especially, is you can remove that capability. So within a day's time or so, the weapons packages and so forth that are put on to make this an armed platform can be removed from the helicopter, and the next day, you can go out and perform a mission of a utility helicopter.

That's some flexibility that doesn't exist right now in the marketplace. And that's something that we think is very interesting that, frankly, would not have happened, but for the synergy between our Missiles and Fire Control organization, the – our MST organization and obviously, Sikorsky now.

Operator

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

Ronald Jay Epstein - Bank of America Merrill Lynch

Hey, good morning, guys. Thanks.

Marillyn A. Hewson - Chairman, President & Chief Executive Officer

Good morning.

Bruce L. Tanner - Chief Financial Officer & Executive Vice President

Good morning.

Ronald Jay Epstein - Bank of America Merrill Lynch

Just maybe a quick update post Farnborough on what's going on with the trainer program and the timeline for that, and how you expect it to go.

Marillyn A. Hewson - Chairman, President & Chief Executive Officer

So, on the T-X program you're referring to, I'm presuming, for the U.S. Air Force...

Ronald Jay Epstein - Bank of America Merrill Lynch

(43:19) Yeah, yeah.

Marillyn A. Hewson - Chairman, President & Chief Executive Officer

Yes. Thank you. I guess where that stands right now is we're standing by with what we consider to be a very good offering. It's an excellent solution, it's low risk, it's – we've got it – it's the T-50A when our joint venture with Korean Aerospace, it's flying right now. We've already had our first flight of our offerings, so we've taken that T-50 with KAI and converted it into T-50A to meet the requirements that the Air Force has outlined, and we're excited about the fact that we've flown it, we're demonstrating it, and we think we have an excellent offering.

Now the RFP appears to be slipping out, it's slipping out into the December timeframe. So, we'll – I think that what I understand is that the Air Force wants to revisit what they've outlined as the requirements for that capability, and they will slip the RFP out some, and we stand ready to support that. But in the meantime, we are continuing to roll out our capabilities and showcase that capability. It's a big program, it's about 350 aircraft, so it's an opportunity for us. In our case, there is some discussion around whether or not the Air Force wants to pursue a clean sheet design or an existing design. We believe that with the tremendous gap on the training capabilities, the T-38 is – I don't think it's close to 50 years old or something like that, it's – they need to replace that aircraft. And the fact that we have a low risk aircraft that's already flying that can meet today's requirements, we think we're offering something that would allow the U.S. Air Force to move forward on the program and meet that capability. There are other offerings out there as well that are not clean-sheet. And so, we like to compete and we think we have a tremendous offering.

Operator

Thank you. Our next question comes from the line of George Shapiro with Shapiro Research. Your line is open.

George D. Shapiro - Shapiro Research LLC

Yes, Bruce, a couple of quick things. Previously you had said that with the Leidos transaction that you would buy sufficient stock to offset the dilution.

Given where the stocks are now, you'd probably have to use all of the $1.8 billion and maybe even to touch more to offset the dilution, so is that still the intent? And then second, you took about a $30 million charge, it looks like on the international contract that you alluded to in the Q1 document, and I was just wondering if you think that's the end of it? Thanks.

Bruce L. Tanner - Chief Financial Officer & Executive Vice President

Yeah. Thank you, George. So, relative to the share count reduction and whether or not that's enough to sort of offset the dilution effects of losing the IS&GS earnings or not, you're right. At the call when we announced the deal back in January, we said that the share buyback was essentially going to be enough to make that sort of neutral between the two years. Since that time, our stock has increased. If I look at it today, it's up almost 25% over what the number was in January. I think we were trading at around $210 a share the day we announced the deal. So, pretty significant increase on our side, which makes it obviously more expensive to buy back the same number of shares as we'd expected in the January call.

On the other hand, the Leidos stock price has dropped a little bit since that time, so both of those are sort of working against us from a shares perspective, that will be taken out as a result of the RMT transaction. So, where we sit today, George, even with the $1.8 billion, it's probably difficult to get exactly to neutral, but it gets a lot closer there. We still think the economics of this deal relative to all options that we looked at, an outright sale, a pure spin, this is still the best situation for Lockheed Martin and its shareholders and we don't have regret on that. Notwithstanding the fact that to your point we actually may see a little bit of EPS dilution as a result of the stock price movement, I think that's a little bit of a high-class problem that we're experiencing right now, but nonetheless that is where we are.

As to the charge we took, we did take an additional charge, $30 million. You're right. This is sort of the command and control business that we're looking, so think of this as sort of a system that controls all sorts of air missile defense capabilities around an entire country including identifying friend or foes, so that you don't have the wrong issues with the air missile defense capability, so linking into a lot of different systems. We think we have prospects once this system is developed in other places internationally, but we've had some growing pains obviously with this.

And I think as we've gone through the development in early stages of this program, the customer has kind of changed some of what their expectations are, so we are in discussions with the customer right now about sort of closure of this contract. We think where it sits right now, it's pretty well-positioned in terms of the charges we've taken. There is some upside potential to that depending on where the customer wants to head. There could be some downside, so we're kind of in the middle of that right now, George, and obviously we'll keep you apprised as we go through future quarters and let you know how we're performing on that contract.

Operator

Thank you. Our next question comes from the line of Rob Spingarn with Credit Suisse. Your line is open.

Robert M. Spingarn - Credit Suisse Securities (USA) LLC (Broker)

Hi, good morning.

Bruce L. Tanner - Chief Financial Officer & Executive Vice President

Hi, Rob.

Marillyn A. Hewson - Chairman, President & Chief Executive Officer

Hi, Rob.

Robert M. Spingarn - Credit Suisse Securities (USA) LLC (Broker)

Just going back to the F-35, Bruce, you've talked about double-digit margins I think in 2019 and in context with the two new initiatives that Marillyn spoke about that were announced last week, I guess it's around $430 million in new cost and clearly both you and the government are trying to get the best deal done here on 9 and 10. Is that still the trajectory, and how have margins been tracking lately?

Bruce L. Tanner - Chief Financial Officer & Executive Vice President

Yeah. So, Rob, that is still the objective and, just a slight correction maybe on what you said that the two initiatives, sort of the second part of the Blueprint for Affordability and the sustainment activity is more like about $420 million. I remind you, this is an investment....

Robert M. Spingarn - Credit Suisse Securities (USA) LLC (Broker)

Naturally....just go ahead, I'm sorry.

Bruce L. Tanner - Chief Financial Officer & Executive Vice President

Yeah, I think your question, was that shared? And it is in fact shared between ourselves, Northrop Grumman and BAE, just as the first Blueprint for Affordability initiative was. It's hard to say, these are investments and you expect to get returns on your investments. We were getting a return on the Blueprint for Affordability one. We would expect to get returns on Blueprint for Affordability two as well as the sustainment investment that we're making. But notwithstanding that, I still think we're on a trajectory on the F-35 program. And I think I've said, more than having the specific year, it's relating more to when will we get full rate production that we hope to get to double-digit margins by that time. I've always said at similar points in time of the program's life cycle, it ought to look like an F-16 program or an F-22, or a C-130, there's sort of nothing structurally that would prevent us from getting to those levels. And right now, we're sort of tracking towards that trajectory, we've not come off of that at all.

Operator

Thank you. Our next question comes from the line of David Strauss with UBS. Your line is open.

David E. Strauss - UBS Securities LLC

Good morning. Thanks for taking my question.

Bruce L. Tanner - Chief Financial Officer & Executive Vice President

Sure, David.

Marillyn A. Hewson - Chairman, President & Chief Executive Officer

Good morning.

David E. Strauss - UBS Securities LLC

Thanks. Bruce, hate to do it, but going back on pension, I think previously you had said FAS/CAS for 2017, kind of all things staying the same discount rate hitting your assumed rate of return would be about a $450 million positive relative to 2016. So I want to clarify your answer on the prior pension question, where you talked about $350 million, are you talking about $350 million worth off of the projected 2017 level or off of the actual 2016 level? And then the other thing, the $1.8 billion that you're getting in conjunction with the closing on IS&GS, would you potentially look at that for an early pension contribution that potentially offset some of the downside? Thanks.

Bruce L. Tanner - Chief Financial Officer & Executive Vice President

Yeah, yeah. Thanks, David. And I probably wasn't at my clearest when I made that Fed reference in the first quarter. I think I heard feedback as we ran around in investor conferences and so forth, that I think I stumbled with my answer there quite honestly. So I tried to be clearer this time. Obviously, I'm still not being clear, but let me try to be as crystal-clear as I can on this thing.

So FAS/CAS in 2016, the benefit is about $975 million or so. What I said is, I would expect to be between, if we struck the line in the sand right now, probably $350 million to $400 million lower than the 2016 FAS/CAS benefit in 2017. I mean, to do the math that kind of translates into $625 million, $600-ish million dollar income number down considerably from what we were talking about in the first quarter of last year. Almost all of that because of the discount rate change in the 1,000 basis – or not 1,000, 100 basis points as I talked about.

Importantly, back to Rich's question, it's a non-cash item, will not affect our 2017 contributions at all. And that relates to your question relative to the $1.8 billion and we would use that to pre-fund the pension plan. The answer is, we don't have that expectation sitting here today and I don't think that's what we will do with the money. As I said earlier in the – to another question, I think the more likely outcome is probably share repurchases at this point in time and we'll fund the 2018 requirement in 2018. We've already got quite honestly a fairly sizable prepayment credit balance in terms of how much we have contributed to ERISA versus what we've collected from our government contracts and we don't see the point at this time of sort of increasing that level.

Operator

Thank you. Our next question comes from the line of Cai von Rumohr with Cowen & Co. Your line is open.

Cai von Rumohr - Cowen & Co. LLC

Yes, thank you very much. So in the quarter, you had a reasonable book-to-bill of 0.85 at IS&GS and yet my understanding is that that number excluded the FAA contract you got recently and the protested ISR award you had in the second quarter. As you – and yet, you also mentioned the Australian contract had another schedule delay. Can you update us, as you look at next year, what the IS&GS, any color on where the IS&GS numbers might be?

Bruce L. Tanner - Chief Financial Officer & Executive Vice President

So, Cai, I think that's probably across – against an area where we're better suited to point you to the prospectus that we got for the RMT transaction rather than me comment on what IS&GS sales would look like under Lockheed Martin in 2017 when that's not our expectation.

Operator

Thank you. Our next question comes from the line of Carter Copeland with Barclays. Your line is open.

Carter Copeland - Barclays Capital, Inc.

Hey, good morning Marillyn and Bruce.

Marillyn A. Hewson - Chairman, President & Chief Executive Officer

Good morning.

Bruce L. Tanner - Chief Financial Officer & Executive Vice President

Hi, Carter.

Carter Copeland - Barclays Capital, Inc.

Just a question on the F-35, just to clarify and a second part, the sustainment initiative on reducing those costs. You said 10% reduction there or $1 billion in five years implies a – clearly a very large sustainment amount, a $10 billion amount. That seemed kind of large, I just wondered if you could clarify if that was correct?

And then secondly, with respect to the contract action, if you end up getting a UCA on this, in the coming quarter or two quarters, Bruce, is there a particular cost or margin impact to one contract outcome versus another that you're considering in your guidance or in the plan? How should we think about that in terms of how that that gets finalized with the customer. Thanks.

Marillyn A. Hewson - Chairman, President & Chief Executive Officer

With the point to the question, Carter, let me just take the first one on the Blueprint...

Carter Copeland - Barclays Capital, Inc.

Sure.

Marillyn A. Hewson - Chairman, President & Chief Executive Officer

...for Affordability for sustainment. What we announced was an investment of up to $250 million over the next couple of years, much like we did on Blueprint for Affordability for production, this time for sustainment along with BAE and Northrop Grumman. And we're targeting over that five-year period that we would reduce sustainment cost by 10%. So, that's where the $1 billion dollar savings for that five-year period would come from. We've got a lot of projects that we've outlined and so it will be jointly with the U.S. government. They will approve those projects, we'll implement them and then as Bruce said earlier, we will get a return on our investment. I think that answers that question, unless there's something more there, Bruce, that you want to add.

Bruce L. Tanner - Chief Financial Officer & Executive Vice President

Nothing to that. I'll try to address the F-35 LRIP 9 and 10. So, maybe a little bit more than you want, Carter, but – so yeah, there's sort of two ways that we could get cash recovery on this program. One is through what's called an undefinitized contractual action or UCA, you've heard that term obviously in the past. We don't care frankly how we get the cash. If it comes under a UCA though, UCAs get funded essentially and it allows you to bill against the UCA with progress payments. So, we would not recover as much cash under a UCA Although we would still get a significant amount of cash under a UCA funding mechanism as we would have if we actually definitized the contract because under the LRIP 9 and 10, we would expect to have performance-based payments and performance-based payments where we are on the contract today would actually give us greater cash recovery than with the UCA. I hope that made sense.

As to impact on margins and so forth, I wouldn't expect one or the other to have any impact whatsoever on the margins we're negotiating. The only sort of economic impact that we're seeing and we have raised this with the government is, depending on how long this shortfall lasts and I gave you some numbers relative to the shortfall, we could be – if we choose to fund and again avoid the disruption of the, particularly the supply chain on the program and the international partners on the program, if we chose to fund, we probably would have to get in the commercial paper market bigger than we are. And that's not something we look forward to and that's probably something that we'd have to have a conversation about what's equitable if in fact that takes place with the government.

So, a potential for a negative on the commercial paper, but we would expect that there potentially could be some consideration for that. If in fact that's what happened, but that is not our plan as I said.

Jerry F. Kircher - Vice President-Investor Relations

Kat, this is Jerry. I think we've come up on top of the hour here. So, I'll turn it back over to Marillyn for final thoughts.

Marillyn A. Hewson - Chairman, President & Chief Executive Officer

Thanks, Jerry. Well, as we conclude the call today, I want to wrap up again by highlighting that the corporation completed an exceptional quarter and we continue to build on our year-to-date momentum with an increasing DoD budget and a robust backlog. The corporation is positioned for top-line growth and strong cash flows in the future.

Thank you again for joining us on the call today and we look forward to speaking with you in our next earnings call in October. Kat, that concludes the call for today.