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HII - Q1 2016 Huntington Ingalls Industries Inc Earnings Call

EVENT DATE/TIME: MAY 05, 2016 / 1:00PM GMT

THOMSON REUTERS

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PRESENTATION

Operator

Good day, ladies and gentlemen. Welcome to the Huntington Ingalls Industries first-quarter 2016 earnings conference call. (Operator Instructions) As a reminder, this conference is being recorded.

I would now like to introduce your host for today's conference, Dwayne Blake, Vice President of Investor Relations. Sir, you may begin.

Dwayne Blake - *Huntington Ingalls Industries, Inc. - VP IR*

Thanks, Terrence. Good morning and welcome to the Huntington Ingalls Industries first-quarter 2016 earnings conference call. With us today are Mike Petters, President and Chief Executive Officer, and Chris Kastner, Corporate Vice President, Business Management, and Chief Financial Officer.

As a reminder, 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 laws. Actual results may differ. Please refer to our SEC filings for a brief description of some of the factors that may cause actual results to vary materially from anticipated results.

Also, in their remarks today Mike and Chris will refer to certain non-GAAP (technical difficulty) including certain segment-adjusted financial measures. Reconciliations of these metrics to the comparable GAAP measures are included in the appendix of our earnings presentation that is posted on our website.

We plan to address the posted presentation slides during the call to supplement our comments. Please access our website at HuntingtonIngalls.com and click on the Investor Relations link to view the presentation as well as our earnings release.

With that I will turn the call over to our President and CEO, Mike Petters. Mike?

Mike Petters - *Huntington Ingalls Industries, Inc. - President, CEO*

Thanks, Dwayne. Good morning, everyone, and thanks for joining us on today's call. This morning we released first-quarter 2016 financial results that reflect strong overall operating performance driven by program execution at Ingalls. Let me share some highlights starting on page 3 of the presentation.

Sales of $1.76 billion were up 12% from last year, and diluted EPS was $2.87 for the quarter compared to $1.79 last year. Segment operating margin was 9.4%, up from 8.2% last year.

Free cash flow was $17 million, and we ended the quarter with approximately $800 million of cash on the balance sheet. We received $1 billion in new contract awards, resulting in backlog of $21 billion at the end of the quarter, of which $13 billion is funded.

Shifting to activities in Washington there have been a couple of developments I want to mention. First, the Navy released its Submarine Unified Build Strategy which outlines the framework for design and construction of the Ohio Replacement Program. This strategy is the result of a coordinated effort between Newport News, General Dynamics Electric Boat, and the Navy.

It enables the submarine industrial base to execute on the ORP while continuing to deliver Virginia-class submarines in the most cost-effective manner. The arrangement specifies that Newport News will build sections of ORP consistent with the sections they build on the VCS program.

At the same time, Newport News will perform additional final assembly, testing, and delivery work on the VCS program. We are pleased with this outcome and look forward to leveraging our VCS program expertise and experience on the ORP.

Next, there appears to be some interest in Congress to accelerate the start of the LX(R) program from 2020, which is the plan of record, to either 2019 or 2018. We support LX(R) acceleration as it would reduce the production gap between LPD-28 and LXR and leverage the benefits of a hot production line. It also creates a predictable and steady construction schedule for our suppliers, allowing them to make investments in their workforce and facilities that lowers cost and improves efficiencies.

While funding for these items in the remainder of the President's fiscal-year 2017 budget request is debated, our team remains engaged with the Navy, Pentagon, and Congress on all of our programs.

Now I will provide a few points of interest on our business segments. At Ingalls we experienced another strong quarter, as the team continues to execute well and the programs continue to reap the benefits of serial production. Results of the LHA-8 and TAO(X) competition are expected to be announced by midyear, and we still expect contract awards for LPD-28 and NSC-9 later this year.

At Newport News, CVN-78 Ford experienced some challenges in a test program that resulted in a delay of builders' trials. While we're a bit disappointed with this outcome, the challenges are not out of the ordinary for the lead ship of a class as we integrate, test, and troubleshoot contractor- and government-supplied equipment and systems and bring the ship to life. I am very pleased with the condition of the ship, and I'm confident that the team will continue to work closely with our Navy customer to craft the best path to delivery.

Regarding the other major programs at Newport News, the Virginia-class program continues to perform well, and CVN-79 Kennedy ramps up while the CVN-72 Lincoln refueling overhaul and CVN-65 Enterprise inactivation teams continue to drive these programs toward completion.

At UniversalPegasus, contract awards for inspection work in the field services area were recently received, which is creating a modest increase in the backlog. Even with these developments, we will continue reviewing operations to ensure that the business is rightsized for current market conditions while preserving our key customer relationships.

In closing, I want to thank the HII team for another quarter of hard work and dedication and for their unwavering commitment to safety, quality, cost, and schedule. Even though there is pressure at Newport News as they prepare to complete Ford, Lincoln, and Enterprise, we remain focused on program execution, risk retirement, and cash generation. And support in Washington for our key shipbuilding programs continues to create a positive long-term outlook for the business.

That concludes my remarks, and I will now turn the call over to Chris Kastner for some remarks on the financials. Chris?

Chris Kastner - *Huntington Ingalls Industries, Inc. - Corporate VP Business Management, CFO*

Thanks, Mike, and good morning. Starting with our consolidated results on slide 4 of the presentation, revenues in the quarter of $1.76 billion increase 12.3%, driven by higher volumes at Ingalls and Newport News. Segment operating income in the quarter increased 29.7% to $166 million, and segment operating margin improved 126 basis points to 9.4%.

Total operating income in the quarter increased 26.9% to $198 million. Total operating margin improved 129 basis points to 11.2%. These increases were due to strong operating performance at Ingalls and favorable FAS/CAS adjustments.

Cash from operations was $54 million in the quarter, and free cash flow was $17 million. Capital expenditures in the quarter or $37 million or 2% of revenues, compared to $20 million in the first quarter last year. We continue to expect capital expenditures for the year to be in the range of 3.5% to 4.5% of revenues.

In the quarter, we contributed $53 million of the planned $167 million discretionary contributions to our qualified pension plans. We will fund the balance of the discretionary contributions in the second quarter.

We repurchased approximately 367,000 shares at a cost of $48 million during the quarter and paid dividends of $0.50 per share or $24 million, bringing our quarter-end cash balance to $793 million.

Moving on to segment results on slide 5 of the presentation, Ingalls revenues of $576 million increased 24.9% from the same period last year, driven by higher volumes on the DDG and LPD programs and partially offset by lower volume on the NSC program. Operating margin in the quarter of 14% increased 440 basis points over first-quarter 2015 primarily due to performance improvement and risk retirement on the LPD and DDG programs.

Turning to slide 6 of the presentation, Newport News's first-quarter revenues of $1.15 billion increased 8.7% over the same period last year due to the resolution of changes to a commercial energy contract and higher volumes on the VCS program. The increase was partially offset by lower volumes on CVN-72, RCOH, and the construction contract for CVN-78. Operating margin for the quarter was 7.7%, down 105 basis points from the same period last year due to lower risk retirement on the VCS program and lower performance on CVN-78.

Now to the Other segment on slide 7 of the presentation. The segment generated an operating loss of $5 million on revenues of $24 million in the quarter, compared to an operating loss of $10 million on revenues of $40 million in the same period last year.

The decrease in revenues was driven by the continued decline in oil and gas services. The decrease in operating loss was due to lower restructuring cost in the quarter compared to the restructuring cost taken in the first quarter of 2015.

Now let me provide you with an update on our tax rate for the year. As we've noted in our earnings press release this morning, the Financial Accounting Standards Board issued new guidance on accounting for employee share-based compensation that changes how companies account for certain aspects of share-based payment awards to its employees, including accounting for income taxes and classification in the cash flow statement. Under the new guidance, income tax benefits and efficiencies will be recognized as income tax benefits or expense in the income statement.

We adopted the updated guidance effective January 1 of this year. As these are treated as discrete items, there will be volatility and variations in our tax rate during the year based on when these awards are exercised and vested.

For the first quarter, our effective tax rate was 23.2%, different from the federal statutory rate of 35% primarily due to the adoption of the new guidance, which provided an income tax benefit of approximately $18 million for stock award settlement activities in the quarter. For the full year, we now expect our effective income tax rate to be in the 30% to 32% range.

That concludes my remarks for the quarter. I'll turn the call back over to Dwayne for Q&A.

Dwayne Blake - *Huntington Ingalls Industries, Inc. - VP IR*

Thanks, Chris. As a reminder to everyone on the call, please limit yourself to one initial question and one follow-up so we can get as many people through the queue as possible. Terrence, I'll turn the call over to you to manage the Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Myles Walton, Deutsche Bank.

Myles Walton - *Deutsche Bank - Analyst*

Thanks; good morning. I was hoping to start with the margins and obviously a divergence here. A, Chris, could you give us the positive and negative total cumes that will be in the Q?

And B, maybe, Mike, can you talk about the sustainability of -- obviously not all of the good news here at Ingalls is really sustainable; but this is, I don't know, the third or fourth quarter in a row where you're well above trend there.

And then how much of the builder trial delay was more of a one-time-ish impact to the Newport News margins in the quarter?

Chris Kastner - *Huntington Ingalls Industries, Inc. - Corporate VP Business Management, CFO*

Sure, Myles; this is Chris. $76 million positive and $7 million negative for a net of $69 million.

Mike Petters - *Huntington Ingalls Industries, Inc. - President, CEO*

Myles, regarding the margins, we've been talking for five years about the healthy shipbuilding business has a blend of programs that will keep it in the 9% to 10% range. What you're getting here is a peek under the hood at how that blend sometimes works.

We had some really strong risk retirements at Ingalls. We've worked really hard over really the last eight years to get Ingalls into a serial production mode to drive high returns in mature programs.

Newport News is looking at three carrier deliveries in the next year, and so they are a little bit out of balance; and we've been talking about that as well. Combined, though, you still have a very healthy business, and this is how the healthy business works.

As far as what's happening at Newport News specifically to the Ford, we're testing -- this is the lead ship of a class of ships that's going to be out there for the next -- this ship will be out there for the next 50 years. The last time we did a lead ship aircraft carrier program was in the 1970s, as far as a test program goes.

So we have 40 years of new technology in these systems that we're testing. We're testing each of the systems: systems that we built, systems that the government furnished to us.

We're testing the systems themselves. We're testing how the systems interact with each other for a network standpoint, which is not something that was even on the table really 40 years ago. And then as the lead ship, there's a whole set of tests that you do that are lead-ship-specific as well as documentation for the training of the crew that will drive the performance of a whole class of ships going forward.

Our ability to predict the schedule in that environment is probably limited. What our commitment is, is that we are committed to keeping the quality of that test program on track and to do it in the most efficient way, keep the costs as managed as we possibly can.

So, we still believe that we're in good shape there. The ship looks great. You walk on it today, it's really a finished ship except for the folks that are testing it.

And it's not just the Newport News folks that are testing it, but the Navy folks that are involved in bringing that ship to life. The ship will go to sea this summer, and we're targeting a delivery in September or so.

So we see this -- we're on a good path right now to drive the performance of that program all the way through to completion. How that plays out from a schedule standpoint, we'll see. But our commitment here is to make sure the test program is run correctly and we do that as efficiently as we possibly can.

Myles Walton - *Deutsche Bank - Analyst*

Okay, that makes sense. Chris, I'm just making sure I got it right. You said negative $7 million I think for cumes. So that's a pretty low number, which would I guess suggest that what we're seeing in NNS is more of an underlying lower booking rate than any negative effects of cumes and maybe an absence of positives. Is that the correct interpretation?

Chris Kastner - *Huntington Ingalls Industries, Inc. - Corporate VP Business Management, CFO*

Yes, I think that's right. There was a minor adjustment on the Ford, but really just a lower booking rate.

Mike Petters - *Huntington Ingalls Industries, Inc. - President, CEO*

Yes.

Myles Walton - *Deutsche Bank - Analyst*

All right. Thanks, guys.

Operator

Finbar Sheehy, Bernstein Research.

Finbar Sheehy - *Bernstein - Analyst*

Good morning. I wondered if you could give us a little more on the impact of the new submarine building plans. As you -- it's a few years out, of course; but when you do get the work on the ORP and then also additional work on the Virginia-class, are we looking at that being a fairly flat, then, revenue line for you? Or is it a step up or down?

Mike Petters - *Huntington Ingalls Industries, Inc. - President, CEO*

Well, I think the first thing you said is it's pretty far out. I mean, the first ship is not acquired until 2021. So starting to try to predict and think through what that means for us, we're excited about being part of the program.

I think the most important part of what's happened here is that, now that the industry and the government have decided on a path ahead not just for the Ohio-class replacement but also how that's going to impact the Virginia-class program, we as a team can then go figure out how to get all of that done. One thing that's interesting is that the Navy wants to add another Virginia-class program in 2021, at the same time that they are going to be buying the Ohio-class.

We strongly support that, and we have to work with our partner and the government to figure out how is the most efficient way to get that down. So trying to predict how any sort of the revenue might project -- a ship that gets appropriated in 2021 actually gets built over the next five or six years, so that's -- we're talking about 8 to 10 years from now in terms of how that plays out.

It's a really positive development for Newport News. It really indicates how confident and comfortable the Navy is with the performance of the team at Newport News in executing all of the work that they are doing.

Finbar Sheehy - *Bernstein - Analyst*

Great. Thanks.

Operator

Gautam Khanna, Cowen and Company. (Operator Instructions) Jason Gursky, Citi.

Jon Raviv - *Citigroup - Analyst*

Hi, good morning, guys. It's actually Jon Raviv here for Jason. Hey, Mike, just following up on that last question, the Navy's made some decisions how those two ships will interact. How do you see them just simply affording this in the 2020? It's still an off balance sheet thing; got to be within the Navy shipbuilding budget. Where do you see things going based on this sub plan?

Mike Petters - *Huntington Ingalls Industries, Inc. - President, CEO*

I've said for a while now that the number-one issue facing the industry is: How does the Ohio Replacement Program get funded without squeezing out other programs? The Congress and the Navy are trying to work through a funding mechanism. The authorizers have come up with this idea for an account; the appropriators maybe not so much.

My own view is that however it comes together, whatever the mechanics of getting it funded are, whatever they are, what's most important is that it be funded without impacting other programs. Quite frankly, that's why our effort to take advantage of the hot production line on amphibs is really crucial, because my own view is that if you start crowding out other programs, significant auxiliary ships and amphibs and maybe even destroyers start to get impacted by the way that it gets paid for.

So what matters here is that there be extra money. I do not know how that happens.

I'm watching the nation wrestle with this whole idea of our strategic capacity recapitalization. It's not just the Navy; it's the Air Force as well. And I'm watching the Pentagon try to take that on.

It looks like they're taking it on in a positive way, and there is a lot of support for it in Congress. But my guess is we're going to be talking about this every year for the next decade.

Jon Raviv - *Citigroup - Analyst*

All right. I look forward to it. This is a quick follow-up, just on the margins. It's still fair to think that on a blended perspective shipbuilding should be in that 9% to 10% range this year? And then beyond that, what does Newport News look like once Ford actually delivers?

Mike Petters - *Huntington Ingalls Industries, Inc. - President, CEO*

Yes, I think that the healthy business will be in the 9% to 10% range, and we absolutely believe that for the year our shipbuilding business will be in a 9% to 10% range, without any question about that. I think that's pretty predictable over the next -- out to 2020.

Newport News has got three of these deliveries. They've got the Ford delivery, they have the Lincoln delivery, and they have the Enterprise delivery stacked up on each other over the next year or so. So that's going to -- for the next 12 months or so at Newport News it's a period of transition for them.

As they work through these tests programs and delivery programs and move into the production on the Kennedy, the beginning of the next refueling, Block IV in the submarine program, what you'll see at Newport News is you'll see them start to hire people again.

Frankly, unfortunately they're going to be trying to hire back some the people that we've had to lay off. I mean it's fortunate that we're trying to hire them back; it's unfortunate that we had to lay them off in the first place.

So Newport News long-term is setting themselves up for a pretty good run here. It's just we're in a transition period right now.

Jon Raviv - *Citigroup - Analyst*

Thanks so much.

Operator

George Shapiro, Shapiro Research. (Operator Instructions) Robert Spingarn, Credit Suisse.

Robert Spingarn - *Credit Suisse - Analyst*

Good morning. Hey, guys, I guess we've got a couple calls going at the same time. I think that's what's behind this.

But I wanted to -- a follow-up with Chris on Myle's question; and then, Mike, more a strategic for you. Chris, the numbers that you gave us, could you do that by segment?

Chris Kastner - *Huntington Ingalls Industries, Inc. - Corporate VP Business Management, CFO*

Yes, I could. About two-third of it is Ingalls, related to some major milestones they accomplished in the quarter: builders trials in LPD-26 and then launch of LPD-27. And then a third of it at Newport News related to the VCS program.

Robert Spingarn - *Credit Suisse - Analyst*

Both for the positives and negatives?

Chris Kastner - *Huntington Ingalls Industries, Inc. - Corporate VP Business Management, CFO*

The negatives were focused in Newport News.

Robert Spingarn - *Credit Suisse - Analyst*

Got you; okay. Mike, continuing along the long-term strategic submarine plan -- and I recognize what I'm about to ask you is way out in the future. But we've had the opportunity to spend quite a bit of time with the Navy over the past couple of months, and the latest we're hearing about is not only do they talk about maintaining two Virginia-classes alongside one ORP starting in the next decade, but now we're hearing a lot about the retirement of the 688i's, and the fact that three or four of those retire per year starting around the same time.

They want to replace those on a like-for-like basis, so the numbers become staggering if you start thinking about doing three or four attack submarines a year plus an ORP. I have no idea how that would get paid for. But could we even capacitize for something like that?

Mike Petters - *Huntington Ingalls Industries, Inc. - President, CEO*

Oh, I think the industry could support something like that. I think what you're talking about, though, is a problem that -- this is not a new issue. Go back; I first it drew the submarine force structure curve for Newport News when Newport News Shipbuilding belonged to Tenneco.

And you could see that if you're buying them back in the 1980s and the 1990s -- 1970s, 1980s, and 1990s at three and four per year, and then in the future you're going to be buying them at one or two per year, you're eventually going to have a reduction in force that's going to be pretty traumatic. And if your ambition is to get back to the numbers that you had in 1990, you better start on that.

Now the way you do it, though, is you don't show up in 2018 and say: Okay, I want to buy four submarines this year. What you do is you start with a long-term commitment to doing something like that, and then you would add one, and you would expand the capacity of the industry in a sustainable rate.

That will make the capital investment flow. That will make it efficient. That's how you build the force structure.

Quite frankly, that's why the Navy puts a 30-year plan out is because they give the industry that kind of visibility to say: Here's where we're going to go.

Now I don't particularly believe that we're ever going to get to a place where we're building four Virginia-class submarines in any given year within -- at any point in the next decade. I don't see that happening.

I do see that there is a real need for submarines, and that there are real capabilities out there that the Navy is trying to figure out how to replace. So we're working with them to try to figure out the best way to do that.

Ohio replacement is one set of capabilities. The Virginia payload module brings another set of capabilities to the platform. So how we do it -- we may not do it in the same way that we did it before with ships; we may do it with other kinds of capabilities.

Robert Spingarn - *Credit Suisse - Analyst*

Given that, my impression, anyway, is the submarine is the number-one priority in the Navy. I think all these ships are priorities, but if they have to pick and choose, that's the sense that we get. I would think at some point, surface ships might have to pay that bill.

Are you able to resource in such a way -- again this is a somewhat long-term question -- but could you do submarine work if needed elsewhere? I understand not all yards are nuclear certified, so I just don't know how that works.

Mike Petters - *Huntington Ingalls Industries, Inc. - President, CEO*

Well, all the nuclear work would have to continue to be done in Newport News. To try to get another shipyard, whether it's a Huntington Ingalls shipyard or anybody else, to try to get them into a place where they are capable or qualified and certified to do nuclear work is a bridge too far. So if you're going to expand the number of nuclear ships in the fleet it's going to be done from the nuclear shipyards that exist today.

Now, if you think about capacity in the shipyard -- and I think we've talked about this a few times. The capacity in the shipyard is -- a lot of times when you think of a factory you think of it in terms of facilities. But the real capacity in the shipyard is the workforce, and the number of people that you have, your ability to train and create that workforce, your ability to create worksites for those folks to be able to do that work.

I would point out that both of our shipyards are at lower levels of workforce today than they were 25 years ago. So the capacity to build up the workforce there is -- I mean, we have the facilities to do it. The question is really: Can you create the workforce? And on what pace can you do it?

We're pretty good at that, and we have some really strong views as to how fast you can build a workforce. We can build a workforce faster than the Navy can appropriate the money.

Robert Spingarn - *Credit Suisse - Analyst*

Okay. Okay. Thank you for the color.

Operator

Noah Poponak, Goldman Sachs.

Matthew Porat - *Goldman Sachs - Analyst*

Yes, hi; this is Matthew Porat on for Noah. Does the division of work associated with the Ohio Replacement, having the greater potential number of Virginia-class, does it have an effect on margins during that time?

Chris Kastner - *Huntington Ingalls Industries, Inc. - Corporate VP Business Management, CFO*

It's really early to understand that at this point. We don't even know the ORP contracting structure as of yet. We continue to believe a 9%-plus margin business makes a lot of sense.

Matthew Porat - *Goldman Sachs - Analyst*

Got you. Thanks. And has the recent oil rally done anything at UPI? And when might that start to contribute to operating income?

Mike Petters - *Huntington Ingalls Industries, Inc. - President, CEO*

The thing that drives UPI's success is when their customers start reinvesting from a capital standpoint. While the price has moved somewhat, we haven't seen the capital projects start back up again in any consistent way.

We have seen some inspection pickup, which is kind of the phase that we're in. That marketplace right now is inspecting stuff that's been previously built. So that's why you see the backlog going up.

That's good work for us, and we're pretty good at it. But we haven't seen the capital projects turn back on yet in any way to be -- so that we can predict the bottom, if you will.

Matthew Porat - *Goldman Sachs - Analyst*

Got you. Thanks so much.

Operator

Sam Pearlstein, Wells Fargo.

Sam Pearlstein - *Wells Fargo Securities, LLC - Analyst*

Good morning. Chris, can you tell us what the revenue benefit was in Newport News? You talked about a resolution of a commercial contract in energy.

Chris Kastner - *Huntington Ingalls Industries, Inc. - Corporate VP Business Management, CFO*

Yes. It was approximately $100 million.

Sam Pearlstein - *Wells Fargo Securities, LLC - Analyst*

Was there a P&L impact?

Chris Kastner - *Huntington Ingalls Industries, Inc. - Corporate VP Business Management, CFO*

Yes, but nothing significant and worth mentioning. It was really the resolution of a number of change orders that were outstanding on that contract. We settled it in the quarter and that caused the variance.

Sam Pearlstein - *Wells Fargo Securities, LLC - Analyst*

So if I took that out and I said that it imputed an 8.5% margin, that's about the right way to think about the ship side of it?

Chris Kastner - *Huntington Ingalls Industries, Inc. - Corporate VP Business Management, CFO*

I think that's fair.

Sam Pearlstein - *Wells Fargo Securities, LLC - Analyst*

Okay. Then, Mike, you talked about the LX(R), and I guess I've seen the talk about accelerating it. I guess I'm just trying to think through: Is the option that LX(R) comes in a year or two, or is there any chance we could actually get another LPD in there and still keep the LX(R) out where it was?

Mike Petters - *Huntington Ingalls Industries, Inc. - President, CEO*

I think either of those are possible. From our standpoint, what we've -- our position has been that we have got a really solid production line on LPDs operating right now, but that it will end before the plan of record for LX(R) is in 2020 starts.

That, the Congress and the Navy began to build a bridge to cover that gap with LPD-28. But LPD-28 doesn't completely close the gap.

So you really have a choice. You can either bring the other side of the bridge in closer by accelerating the LX(R) program; or if you wanted to build another LPD, that would be fine, too. That would absolutely fill the gap.

Either of those are reasonable alternatives from our standpoint. The decision the Navy made to make the LX(R) platform based on the LPD hull means that this bridging is critically important to maintaining the efficiency and the effectiveness of that decision.

So our point of view is: Let's make sure we finish building the bridge that LPD-28 started. LX(R) is the plan of record; so based on the plan of record it needs to be accelerated. If we decide to build another ship instead, I'm okay with that.

Sam Pearlstein - *Wells Fargo Securities, LLC - Analyst*

But has there been discussion leaning that way, or has all the discussion bit about LX(R)'s timing?

Mike Petters - *Huntington Ingalls Industries, Inc. - President, CEO*

I think there's discussions going on all the time about all of this stuff, so I think the whole range of alternatives is still out there. As I said, our position has been: The bridge has been started and LPD-28 was a great move in the right direction, but it wasn't complete.

Sam Pearlstein - *Wells Fargo Securities, LLC - Analyst*

Okay. Thank you.

Operator

(Operator Instructions) Pete Skibitski, Drexel Hamilton.

Pete Skibitski - *Drexel Hamilton - Analyst*

Good morning, guys; nice quarter. Hey, I guess, Mike, just to beat a dead horse on the margin rate, I want to make sure I'm concluding the right thing here.

At Newport News, as we work through this transition over the next two or three quarters, is it fair to say that they will run a little bit below their historic norm, but you think maybe Ingalls will run a little above their historic norm, so you net out at the segment level above 9%? Is that the right way to think about that?

Mike Petters - *Huntington Ingalls Industries, Inc. - President, CEO*

That's a way to think about it. I think that both of these sites are pretty lumpy in the way that these things work out. You've been with us for the whole five years. You know that trying to predict what happens in any particular quarter is -- that's a pretty risky project. What I would tell you is that by the end of the year the shipbuilding business will still be in the 9% to 10% range.

Pete Skibitski - *Drexel Hamilton - Analyst*

Okay, okay; fair enough. Then just one follow-up if I could on the CapEx ramp plan. Has the ramp actually begun? Is that fair to say? Are you guys approving projects as part of the plan?

Are you still holding this year to that 3.5% to 4.5% guidance?

Chris Kastner - *Huntington Ingalls Industries, Inc. - Corporate VP Business Management, CFO*

Yes, Pete, we're right on schedule. We spent $37 million in the quarter, and we are on path for 3.5% to 4.5% for the year.

Pete Skibitski - *Drexel Hamilton - Analyst*

Okay. Okay, thanks, guys.

Operator

Roman Schweizer, Guggenheim Securities.

Roman Schweizer - *Guggenheim Securities LLC - Analyst*

Yes, thank you very much. Good morning, guys. So just quick question on Ohio-class. Obviously, design activity is starting to ramp up and I guess the Unified Build Strategy covers more of the production aspect of it. Can you describe how you guys are participating in the design perhaps for the modules or section that you guys are going to do?

Mike Petters - *Huntington Ingalls Industries, Inc. - President, CEO*

Sure. That's what's important about that Build Strategy was to -- optimally you would like to be in the place where whoever is building that part of the ship is doing the design work for that part of the ship, and is also going to handle the procurement of equipment and material for those parts of the ship. So getting clarity around all of that on the front end of this is pretty important to the design piece.

As we go forward, that's the notional plan. There will be puts and takes where there are some integrated systems that carry over from one place to another, so that we've got to work through those things.

But we did that on Virginia-class. We actually did it on Ford as well. We had some support from the designers in General Dynamics to help us do the Ford early on, based on their experience with Virginia-class program.

So the two companies are really good at sorting out this design stuff and who is the best person to do it, because we're both committed to driving the efficiency of the program. But notionally and nominally it's going to be -- you're going to end up doing the design, going to do most of the design for the work that you're going to build, and you're going to do most of the procurement for the stuff that you're going to build.

Roman Schweizer - *Guggenheim Securities LLC - Analyst*

Great; thank you. Just as a follow-up, I think at the beginning of the year you guys were about 16% complete with Kennedy; probably a few points better than that now. Can you just maybe describe a little bit how you guys are tracking to plan?

Obviously the learning curve compared to Ford is going to be a little bit different; probably a lot different than what you proposed under the contract. But how is that -- about 20% into the program, how are you guys doing?

Mike Petters - *Huntington Ingalls Industries, Inc. - President, CEO*

Yes, actually that's a great question. I appreciate the chance to talk about that.

The Kennedy is not quite 20% complete yet. We took a substantial learning target or challenge on the labor side of that program. At about a little less than 20%, we're exactly on budget on labor.

On the material side, we're very -- and we're very happy about that. That's a learning curve that is pretty -- was really indicative of the lessons that we learned from putting Ford together. The team, as it transitioned its lessons learned into new facilities and new work teams and validating the work plans, getting the material side of it sorted out, that has been going exceptionally well.

Materials side is essentially on budget. We're not quite -- I think we're about two-thirds committed. We're about a little more than a third out, and we're doing pretty well there too.

We have a cap on Kennedy as well, a cost cap on Kennedy as well for the whole program. Our piece of it, we're being very successful in supporting our piece of the cap there.

So we're excited about the way that Kennedy has already started, and that's a tribute to what the guys are doing down there on both the Ford and the Kennedy.

Roman Schweizer - *Guggenheim Securities LLC - Analyst*

Great. Thank you very much.

Operator

Ronald Epstein, Bank of America.

Kristine Liwag - *BofA Merrill Lynch - Analyst*

Hi, good morning; it's actually Kristine Liwag calling in for Ron. Hey, guys, with the $1.5 billion in CapEx over the next five years, I was wondering if you would see a similar uptick in Company-funded R&D. And with your discussions with the Navy, how do they think about risk-sharing during the development phase?

Mike Petters - *Huntington Ingalls Industries, Inc. - President, CEO*

Well, first of all, I think on the R&D side of it what probably is a little bit different for us is that 80% of the R&D that we do is tied more to process than it is to technology in terms of the next gadget or anything like that. And the process investment that we make, quite frankly, is right now being driven by the capital improvements that we're making.

So if you really wanted to be, I don't know, poetic about it, you would say that the capital improvements that we're making in our business -- capital investment that we're making in our business is really R&D for this kind of business. I know that's not exactly right, but that's a way to think about it, is that you build the drydock where you can build an aircraft carrier; you have created something that nobody else has. And that's -- it's capital, but in the same way that a new gadget would be something that nobody else has from an R&D standpoint.

As far as risk-sharing goes, it just depends on the program and what you're trying to get done. The Navy is -- whenever we sit down to have a discussion with the Navy about construction of the platform, we are in a discussion -- we all know how much has been appropriated for the platform. We're really in a discussion about: How are we going to allocate risk on that between the government and the Company to get us to a place where we have a reasonable contract that makes sense for both parties?

If we're in some sort of development program, then the government has been -- that changes the risk equation. Take Ford, for instance; there was a lot of new technology put in on the Ford. The government and the Company agreed that the best way to take that risk on was through a cost-type contract.

Typically, our carrier programs are fixed-price incentive contracts. The Kennedy, for instance, is a fixed-price incentive contract.

But being the lead ship with all of the risk that goes with that, the Company and the government felt like the most efficient way to do that and the most effective way to do that was in a cost-type contract. So risk discussion in development is something that we do all the time with the government, and we have a very rich discussion about that. But we usually end up coming to some kind of an agreement.

Kristine Liwag - *BofA Merrill Lynch - Analyst*

Great. A follow-up question if I may, and my follow-up is on the LPD program. From my understanding, in 2016 you have essentially an overlap of two LPDs with the 27 and 28; but then it just drops off to just the 28 after 2017.

So I was wondering. How should we think about the margin progression of that program as it goes through 2016 and 2017?

Chris Kastner - *Huntington Ingalls Industries, Inc. - Corporate VP Business Management, CFO*

Yes, that's right. We deliver LPD-26 this year and deliver LPD-27 next year. We don't provide margin rates by program specifically. But we think on a long-term basis our shipbuilding business will be at a 9%-plus.

Kristine Liwag - *BofA Merrill Lynch - Analyst*

Great. Thank you.

Mike Petters - *Huntington Ingalls Industries, Inc. - President, CEO*

And what you're talking about on the LPD program happens to us on lots of programs all the time, as we wind down one program and start up other programs. That's why we try not to -- we just don't break it out by program. We are much more blended. It's the blending of the margins that matters.

Kristine Liwag - *BofA Merrill Lynch - Analyst*

Thanks.

Operator

George Shapiro, Shapiro research.

George Shapiro - *Shapiro Research - Analyst*

Yes, good morning. Two questions. One on EACs. They were, as you said, Mike, $69 million this quarter. That's very high for the first quarter.

I mean, last year the first quarter was $55 million, and before that it was lower. Is this just timing, or are we now going to see a higher level throughout the year?

Chris Kastner - *Huntington Ingalls Industries, Inc. - Corporate VP Business Management, CFO*

George, this is Chris. It's really related to hitting some major programmatic milestones, primarily on the LPD program. So it's not really a quarter-to-quarter thing. It's when does the program reach these major milestones when they can assess their EACs and potentially retire some risk.

So it was really programmatic, and it will remain lumpy as you move through the year.

George Shapiro - *Shapiro Research - Analyst*

Okay. Because like last year you averaged maybe for the year more like $60 million a quarter. So this quarter is just probably above average, then?

Chris Kastner - *Huntington Ingalls Industries, Inc. - Corporate VP Business Management, CFO*

Not sure at this point. You have to move through the year and move through the delivery cycle for the ships, and we'll assess the risk when we get to those major program milestones.

George Shapiro - *Shapiro Research - Analyst*

Okay. Mike, can you provide some color for sales for the year? You've been saying the business will be flattish.

But even if I take out the $100 million as a one-time benefit to Newport News, the sales were still up 6% in the quarter. Are we still looking for flattish, or it's going to be higher this year?

Mike Petters - *Huntington Ingalls Industries, Inc. - President, CEO*

Everything is lumpy, George, and I would just say it doesn't change my view of the business. This is a pretty flat business that's going to operate in the 9% to 10% range.

George Shapiro - *Shapiro Research - Analyst*

Okay. Thanks very much.

Operator

(Operator Instructions) Gautam Khanna, Cowen and Company.

Gautam Khanna - *Cowen and Company - Analyst*

Yes, forgive me, I'm juggling two concurrent calls. So just on the Kennedy, if we could talk about some of the major programmatic milestones we should be monitoring, what are the big risk items as we look through the year and perhaps next year? Big planks of potential EAC catch-up or -- I'll leave it to you to explain it.

Chris Kastner - *Huntington Ingalls Industries, Inc. - Corporate VP Business Management, CFO*

Essentially the major programmatic milestones in the lifecycle of a ship when risk can be retired -- so you can look at builders' trials, you can look at launch, obviously delivery. It's the essential or the important programmatic milestones in the lifecycle of a ship.

Mike Petters - *Huntington Ingalls Industries, Inc. - President, CEO*

Yes, and over the next couple of years on the Kennedy, you're going to not see too many of those really big, high-visibility kinds of milestones. Inside of our risk registers we look at where should we be when we take that unit into the drydock, in terms of: How complete is it? How complete did we want it to be? How much work did we defer to the drydock? How much work did we complete in advance of it going into the drydock?

We build these big units out in an area we call the platen area. One thing that I'm really excited about, about Kennedy, is that the units that -- when we build them in the platen area, but then when we take them to the drydock --.

Ford was good because we had more complete units on Ford going into the drydock than we had had on previous carriers. But even in the case of Ford we still had material issues and qualification of vendors and things like that that typically go on with a lead ship.

We've got most of that behind us at this point. So the units that are going into the dock on Kennedy today are even more complete than they were on Ford when Ford went in. And we need that to happen to drive the performance the way we want it to go.

That's why you see that, even with the big learning curve in labor that we've taken to drive efficiency on the Kennedy, we're achieving that right now, because we're getting that kind of completion on these kinds of milestones. They are not terribly visible. They are not going to be anything that you can track really, because we don't have a press conference every time we take a unit into the drydock.

But it is -- we're very encouraged about the way it's going right now.

Gautam Khanna - *Cowen and Company - Analyst*

I guess to sum up, you don't view this year as a big (technical difficulty). There is not a lot of these risk retirement milestones (multiple speakers)?

Mike Petters - *Huntington Ingalls Industries, Inc. - President, CEO*

No, it's early in the Kennedy program. The Kennedy is going to deliver in 2021 -- or 2022, I guess. Our classic approach is to not take credit for risk retirement until we actually retire it.

Taking units to the drydock is great. But you've got to get through the ship launch; you've got to get through the test program. There's a whole lot of stuff to work through over the next six or seven years out there for Kennedy.

Gautam Khanna - *Cowen and Company - Analyst*

Okay, I appreciate that. Maybe you covered this, but if you haven't, any comments on where the icebreaker stands?

Mike Petters - *Huntington Ingalls Industries, Inc. - President, CEO*

The Coast Guard is talking about an icebreaker program. We're very interested in that program and have been working to understand more what their requirements are.

As we move down that path, you're on the very front end of the program at this point. The Coast Guard is talking to the industry about what's the art of the possible, and we're engaging in that conversation. We'll see how that plays out and when it becomes a real program.

Gautam Khanna - *Cowen and Company - Analyst*

Thank you very much, guys.

Operator

Robert Spingarn, Credit Suisse.

Robert Spingarn - *Credit Suisse - Analyst*

Mike, just while we're on the discussion of the carriers, one of the things we heard was that on Ford there is a -- I don't know, maybe the numbers aren't up to date -- but a couple hundred rooms that are undone or uncomplete, incomplete. Understanding it's a lead ship and these things take time, how does that factor in for the Company in terms of finishing that work?

Is that your work? Does that belong to other contractors? Does that extend revenue to a certain point? And then are there any cost perturbations that we might need to think about?

Mike Petters - *Huntington Ingalls Industries, Inc. - President, CEO*

Yes, Rob, frankly, this is the normal path through delivery for an aircraft carrier. You're talking about a city of 5,000 people complete with its own airport that actually travels around the world at high speed. So when the ship delivered -- there is a discussion between the Company and the Navy about: What are the things that you know enough to do right now? There are some things that you won't finish now because the technology is not available to insert in that space, and so you'll reserve this. Instead of building the space so you can tear it apart and put something new in it, you just reserve the space until the system or whatever it is the Navy wants to put in there is available.

This goes on an every carrier delivery, to figure out exactly what the delivery condition will be, and then how does it get moved ahead in terms of you get work done. Do other contractors come in and get to do some of that work? It depends on the system.

I don't know exactly really what to say about that, except that if you think about the amount of -- how fast technology changes, the design and build -- the detailed design and construction contract for the Ford was signed in 2008. So there's bound to be things that we had not thought about in 2008 that need to be done on this ship before it deploys. So working with the Navy to make sure we do that as efficiently as possible is part of the normal process.

Robert Spingarn - *Credit Suisse - Analyst*

But to the extent that that work is yours, is that like 9% margin work as it comes in, or 8%? Or is it potentially a source of a drag, like what we saw (multiple speakers)?

Mike Petters - *Huntington Ingalls Industries, Inc. - President, CEO*

What I would tell you is you won't see it.

Robert Spingarn - *Credit Suisse - Analyst*

Okay.

Mike Petters - *Huntington Ingalls Industries, Inc. - President, CEO*

It's in the thickness of a pencil in terms of our overall results.

Robert Spingarn - *Credit Suisse - Analyst*

So it's minutia from a relative perspective.

Mike Petters - *Huntington Ingalls Industries, Inc. - President, CEO*

Exactly. Exactly right.

Robert Spingarn - *Credit Suisse - Analyst*

Got it. Okay, thanks.

Operator

At this time I'm showing no further questions. I would now like to turn the call back to Mike Petters for closing remarks.

Mike Petters - *Huntington Ingalls Industries, Inc. - President, CEO*

Well, I thank anybody for their interest today. We're very proud of the work that we've done this quarter. We're very proud of the work we've done for the last five years.

I think you've gotten a chance now to see in some detail how the blending of mature programs and new programs comes together to keep a healthy business in the 9% to 10% range. We look forward to working with you guys over the rest of this year, and we hope you all have a good day. Thank you all very much.

Operator

Ladies and gentlemen, thank you for your participation in today's conference. This concludes the program. You may now disconnect. Everyone have a great day.