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HII - Q2 2016 Huntington Ingalls Industries Inc Earnings Call

EVENT DATE/TIME: AUGUST 04, 2016 / 1:00PM GMT

THOMSON REUTERS

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PRESENTATION

Operator

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

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

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

Thanks, Skyler. Good morning, and welcome to the Huntington Ingalls Industries second-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 fact are considered forward-looking statements and are made pursuant to the Safe Harbor provisions of federal securities law. Actual results may differ. Please refer to our SEC filings for a 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 measures, including certain segment and adjusted financial measures. Reconciliations of these metrics do 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. We released second-quarter 2016 financial results this morning that reflect strong overall operating performance driven by program execution at Ingalls.

So let me share some highlights, starting on page 3 of the presentation. Sales of $1.7 billion were down 3% from last year, while diluted EPS was $2.80 for the quarter compared to $3.20 last year. But note that last year's EPS included a benefit of $1.80 per share for an insurance litigation settlement and a goodwill impairment charge of $0.96 per share.

Free cash flow was $121 million, and we ended the quarter with approximately $850 million of cash on the balance sheet. We received $900 million in new contract awards, resulting in backlog of approximately $21 billion at the end of the quarter, of which $13 billion is funded.

Regarding activities in Washington, House and Senate [comferies] have begun the process of reconciling the FY17 defense policy bill. And measured progress is also being made in the markup for floor consideration of respective appropriations bills. We are encouraged by the strong bipartisan support for Navy and Coast Guard shipbuilding progress in the various committee markups and bills, but remain concerned about the prospect of a long-term continuing resolution, as well as the implications of returning to a sequestered top line for defense spending after the two-year Bipartisan Budget Act of 2015 ends.

Given the Navy's firm commitment to funding the Ohio replacement program, a sequestered top line would create significant funding challenges across the Navy's budget that could severely impact a broad array of shipbuilding and ship repair programs.

We will continue to be vocal about this situation so that all stakeholders are aware of the implications to HII and the shipbuilding industrial base.

Now let me share a few operational highlights. At Ingalls, risk retirement resulting from delivery of LPD-26 John P. Murtha drove another strong quarter. The team is preparing for delivery of DDG-113 John Finn and NSC-6 Munro, both expected by the end of the year. They also continue to leverage lessons learned and the benefits of serial production across all of their programs.

In addition, the announcement that Ingalls was selected to build LHA-8 and receive the majority of the LX(R) design work was a very positive development that positions Ingalls well for the future.

Yet Newport News, we continue to work closely with our Navy customer on CVN-78 Ford, and to establish the appropriate path to delivery. We are also ensuring that these and all other lessons learned from the Ford are leverage to mitigate potential impact of CVN-79 Kennedy, which continues to perform in line with our expectations.

Shifting to submarines, the Virginia-class program continues to perform well as the team prepares for the expected delivery of SSN 787 Washington, the 14th Virginia-class submarine, by the end of the year.

And finally, the team continues to make progress toward completion of the CVN-72 Lincoln refueling overhaul and CVN-65 Enterprise in activation, and is actively working with the Navy to determine the appropriate path to re-delivery for both of the ships.

So, in closing, I am very pleased with the results for the first half of the year, and our long-term outlook for the business remains unchanged. We continue to execute well in our shipbuilding businesses and are moving forward with capital projects that are increasing efficiency and enhancing affordability for our customers. And as always, we remain laser-focused on program execution, risk retirement, and cash generation that creates long-term, sustainable value for our shareholders.

So 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. - CFO and EVP of Business Management*

Thanks, Mike, and good morning. Today I will review our second-quarter consolidated and segment results. But before I do, to make the comparisons clear, let me remind you of a couple of non-recurring items we adjusted for in second-quarter 2015. In second-quarter 2015, we received $150 million in cash for an insurance litigation settlement. As a result of the settlement, Ingalls' revenues declined $13 million, and operating income increased $136 million.

Additionally, in second-quarter 2015, we took a $59 million goodwill impairment charge in the Other segment. Where applicable, the numbers I discuss today will be compared to the adjusted second-quarter 2015 numbers. Please refer to the slides posted on our Investor Relations website for more information.

Starting with our consolidated results on slide 4 of the presentation, total revenues in the quarter of $1.7 billion decreased $58 million or 3.3% from second-quarter 2015, driven primarily by lower volumes at Newport News. Segment operating income in the quarter increased $18 million to $184 million, and segment operating margin increased 138 basis points to 10.8% from second-quarter last year.

Total operating income in the quarter increased $25 million to $217 million, and total operating margin improved 184 basis points to 12.8%. These increases were due primarily to strong operating performance at Ingalls and the favorable FAS/CAS adjustment.

Turning to slide 5, cash from operations of $169 million in the quarter, after we funded the remaining $114 million of the planned $167 million discretionary contributions to our qualified pension plans for 2016. Free cash flow was $121 million.

Capital expenditures were $48 million or 2.8% of revenues in the quarter compared to $29 million in second-quarter last year. Our CapEx spend is typically back-end loaded for the fiscal year, so we continue to expect capital expenditures for the year to be between 3.5% to 4.5% of revenues.

Additionally, we repurchased approximately 239,000 shares at a cost of $36 million during the quarter, and paid dividends of $0.50 per share or $24 million, bringing our cash balance at the end of the quarter to $852 million.

Now the segment results on slide 6 of the presentation. Ingalls revenues of $585 million increased 4.7% 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 15% increased 395 basis points over second-quarter 2015, primarily due to higher risk retirement on LPD-26.

Turning to slide 7 of the presentation, Newport News second-quarter revenues of $1.1 billion decreased 6.5% from second-quarter last year due to lower volume on aircraft carriers CVN-78 and CVN-72, as well as lower volumes on the VCS Block III boats. Operating margin in the quarter was 9.4%, which was relatively flat to second-quarter 2015.

Moving on to the Other segment on slide 8 of the presentation, the segment generated an operating loss of $6 million on revenues of $27 million in the quarter compared to an operating loss of $5 million on revenues of $35 million in the same period last year. The decrease was driven by lower volumes in oil and gas services and contract mix. The operating loss in the second quarter of 2016 included $1 million of restructuring costs as we continue to look for ways to take cost out of the segment.

Now let me talk about pension. Through the end of the second quarter, our year-to-date return on assets was approximately 6% compared to our expected return on assets assumption for 2016 of 7.5%. Also, our pension discount rate dropped approximately 70 basis points from the rate at the beginning of the year of 4.73%.

Based on the pension sensitivity we provided in our 2015 10-K, for every 25 basis point decrease in discount rate, our FAS expense would increase by $19 million from the 2016 estimates. This incremental decrease in the discount rate would also increase our pension liability by approximately $215 million. Again, this is assuming all things being equal to the assumptions used to determine the FAS expense for 2016.

Now let me provide you with an update on Avondale. We officially closed the facility in October 2014. In connection with the closure, we incurred restructuring and closure costs, including severance from relocation expenses as well as asset write-down costs. We have been working with a customer since the closure of the facility to recover these costs.

As we approach the expiration date for the statute of limitations to make a claim, we wanted to preserve our rights. So, in June, we submitted a formal request to the customer asking for a final decision on the matter. The customer has up to 60 days to either provide a decision or inform us of how long it will take them to render their decision. We will keep you updated as we go through this process with the customer.

To summarize, this was a solid quarter and a good first half of the year. While positive performance continues at Ingalls, we will continue to see volume and margin pressure at Newport News as we focus on delivering the three aircraft carriers.

With that said, we continue to expect total revenues in fiscal year 2016 to be relatively flat to 2015, and segment operating margin in shipbuilding to be in the 9% to 10% range. That concludes my remarks for the quarter.

I will turn the call back over to Dwayne for Q&A.

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

Skyler, I will turn it over to you to manage the Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Gautam Khanna, Cowen and Company.

Gautam Khanna - *Cowen and Company - Analyst*

Great results. I was wondering if you could quantify what the cash contribution to the pension -- recognizing that it's discretionary -- if you were to [smash] the line today on pension, for next year, what the cash contribution would be.

Chris Kastner - *Huntington Ingalls Industries, Inc. - CFO and EVP of Business Management*

Yes, it's a good question, Gautam. And it's really too early for cash contributions for next year. We will assess that as we move through the year. As you know, we've been concerned about the updated mortality tables in 2017. It looks like, based on the IRS not submitting those yet or making those available, that could move to 2018. So, we're watching that very closely, and we will be able to discuss that with you at our year-end call.

Gautam Khanna - *Cowen and Company - Analyst*

Okay. And I was wondering if you could also talk a little bit about CVN-78, and what, if any, exposure you guys may have to the delays. I just wondered. I imagine they are accrued for, but there's a lot in the press, and I was just wondering if you could set the record straight.

Chris Kastner - *Huntington Ingalls Industries, Inc. - CFO and EVP of Business Management*

Well, don't really want to comment about the delivery. I will say the ship is essentially done. And in the quarter, we had no material adjustments related to that ship.

Mike, if you want to comment about the delivery date or the schedule?

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

Yes, sure. Our job is to get the ship ready to go as soon as it's ready, and the team there is doing a tremendous job of doing that. We've talked about the test program and the challenge of a lead ship in general, and this one in particular. And we're working through every day down there. It's an adventure.

Our objective right now is to get the ship gone as fast as we can. The Navy has posted a schedule. We're working very hard to support that schedule, and believe it to be achievable; but recognize that it is a lead ship and it is a test program, and we're working our way through it.

Gautam Khanna - *Cowen and Company - Analyst*

But just to be clear, your financial exposure to any of these last-second delays that are happening is well covered, because it's cost plus. And these are not things that you are actually causing -- your firm is causing. Is that a fair assessment or not?

Chris Kastner - *Huntington Ingalls Industries, Inc. - CFO and EVP of Business Management*

That's fair. But you have to assess it every quarter. We know now; we assessed it in Q2, and our profit assumptions assume that. The ship, like I said, is essentially built. We're coming through test issues, not only on government-furnished property but for the balance of the ship. So we think we have it captured now. But you have to go through completing delivery until you can finally understand what your final margin projections will be.

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

And every system is unique in that some systems are government-furnished; some systems are systems that we have done; some systems are stuff that our suppliers have done. And so in every circumstance, you have to evaluate who's accountable, and how will that accountability be assessed. And so, the fact that it's a cost plus contract means that the cost of the work is covered, but then the overall impact of it still has to be assessed on the system-by-system basis.

Gautam Khanna - *Cowen and Company - Analyst*

Fair enough, guys. Thank you very much.

Operator

George Shapiro, Shapiro Research.

George Shapiro - *Shapiro Research - Analyst*

Yes, I was wondering if you could provide how much the EAC adjustments were, particularly at Ingalls, since the margin there is one of the highest I've ever seen for a shipbuilder.

Chris Kastner - *Huntington Ingalls Industries, Inc. - CFO and EVP of Business Management*

Thanks, George. Yes, the nonrecurring or cume adjustments in the quarter were 91 positive and 17 negative. And of that, net, it's about 70/30 Ingalls.

George Shapiro - *Shapiro Research - Analyst*

Okay. And then maybe for Mike, if you could comment a little bit more in the challenging Newport News that you talk about for the second half. I guess we're kind of [vent doing the bathtub] that I know you've talked about for a while. Thanks.

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

Yes, thanks, George. We've been talking. The fact that we have these three carriers to deliver, and we've got a gap between the delivery of the Lincoln and the arrival of the George Washington caused by the budget process back in 2012 -- that created that challenge. We've got three carrier deliveries that are essentially on top of each other, which means that you don't have one delivery team; you have three delivery teams, and that's quite a challenge for the business.

We've been talking about that for several quarters now. This is the kind of business where you can see it coming; you can anticipate it; you can plan for it, but you still got to grind your way through it. And right now through probably the second half of next year, Newport News is going to be grinding their way through this.

You get to the other side of that, though, with the Virginia-class program; the agreement on the Ohio replacement program; the contract that we have for the Kennedy, which is executing well; the contract that we just signed for the Enterprise, which is the ship after Kennedy, which delivers in 2027.

And you have George Washington here in refueling. And you have the planning for [SENUS] beginning -- yes, it's a grinding time for Newport News right now, but the horizon is really bright for that shipyard. So we're excited about where this is going to go. We're just grinding right now for the next year or so.

George Shapiro - *Shapiro Research - Analyst*

And any way you could quantify what you think the margin risk might be for Newport in this period?

Chris Kastner - *Huntington Ingalls Industries, Inc. - CFO and EVP of Business Management*

I think the best way to think about it is for the year, and over the next five years, it's really 9% to 10% of return on sales. I'd hate to try to quantify it at Newport News (multiple speakers).

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

George, we really -- you've see now, in 5 1/2 years of this, that to quote Barb, this is pretty lumpy and things move around quite a bit. And to try to handicap where things might be next quarter or even the second half of the year can be a bit challenging, especially given the dynamic that's at Newport News right now.

But our long-term prospect and view and perspective just does not change. The healthy business in shipbuilding is going to operate in a blended way across time at a 9% to 10% range. And we think that's very predictable. We're committed to that. And we've got everybody pulling on the rope to make that happen.

George Shapiro - *Shapiro Research - Analyst*

Okay. Thanks very much, and good luck.

Operator

Joseph DeNardi, Stifel.

Joseph DeNardi - *Stifel Nicolaus - Analyst*

Mike, you mentioned the risk around continuing resolution. I'm wondering if you could just provide a little bit more color as to where you see your exposure there, what program specifically you think could be impacted?

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

For us, we're probably not terribly impacted by a continuing resolution in that there's not a lot of new starts. That's the real issue with continuing resolutions, is if there is a new start, it can hold up the start of the program. For us it's more about the carryover from one year to the next, and the consistency and giving the Pentagon the perspective that they can go ahead and do the strategic planning that they need to do. Fundamentally, I just think it's bad process for us to have a continuing resolution instead of a budget.

And in the main, we're starting to rely on continuing resolutions way too much. And our concern here is that the continuing resolution may actually be longer than December. It may go into the next administration, which just creates a whole lot more uncertainty. And so we would rather see this get closed out as quick as we can.

Joseph DeNardi - *Stifel Nicolaus - Analyst*

Great, okay. And Chris, just on the discussions you are having with the Navy over Avondale, is this just the standard practice of business? Or is there a disagreement in one facet of the negotiations that's causing this to maybe take a little bit longer to get done?

Chris Kastner - *Huntington Ingalls Industries, Inc. - CFO and EVP of Business Management*

Well, yes, it's a good question. There's obviously a disagreement between the parties, or we would have had this settled. So, we're butting up against the statute of limitations, and we thought it made sense to protect our rights to get it into a more formal process. Really, the last thing you want to do -- and it's unfortunate, and it could delay recovery a bit -- but we thought it was the right thing to do to protect our rights there.

Joseph DeNardi - *Stifel Nicolaus - Analyst*

Okay. And could you quantify maybe how much is being disputed of the total recovery?

Chris Kastner - *Huntington Ingalls Industries, Inc. - CFO and EVP of Business Management*

I'd really rather not quantify that at this point. We will get more visibility when we get their final decision, and we'll have to asses that. And then we'll communicate to you any impact that we may have.

Joseph DeNardi - *Stifel Nicolaus - Analyst*

Okay. Thank you.

Operator

Myles Walton, Deutsche Bank.

Myles Walton - *Deutsche Bank - Analyst*

Chris, was hoping to circle around the pension just real quick. You gave us the sensitivity and the spot rate of where you are on ROA year-to-date. But obviously as a starting point, would have to know what your plan was for 2017 on a FAS/CAS basis. Was that planned to be down, and this is headwind to it being down? Or was FAS/CAS planned to be up, and this is headwind to it being up?

Chris Kastner - *Huntington Ingalls Industries, Inc. - CFO and EVP of Business Management*

Yes, well, we didn't -- obviously we haven't provided 2017 numbers for FAS/CAS adjustment yet. You're probably aware, or I think you're aware, that that's the last year of harmonization. So it was relatively consistent, all things being equal. But like I said, we haven't provided guidance, and we will be able to come through that over the balance of the year and give that to you beginning of next year. A lot of things moving in pension; we don't like to get ahead of ourselves on it.

Myles Walton - *Deutsche Bank - Analyst*

So just for clarity, though, you said this is the last year of harmonization, meaning that CAS would rise again proportional to what we saw in 2016, or it would -- or 2016 was the last year?

Chris Kastner - *Huntington Ingalls Industries, Inc. - CFO and EVP of Business Management*

Yes, I don't want to speculate rise proportionally. But it is the last year of harmonization, so your CAS costs should be higher than your FAS expense, for sure.

Myles Walton - *Deutsche Bank - Analyst*

Okay, great. And Mike, so you have sort of been asked this, but I want to ask it in a different way. The CVN-79 versus the 78, obviously you are under fixed price in the 79 versus the 78. You've got some realization of challenges on the 78.

Just from a workshare perspective and a hiving-off risk, is the GFE portion on the 79 the same as it was on the 78, such that whatever problems that are arising on the GFE, the risks that are materializing on the 78 are similarly as walled off as they could be on the 79? Thanks.

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

Yes, that's right. There's some of the GFE that would ordinarily have migrated over to CFE, contractor furnished, by the second ship. But Myles, if you remember, as we negotiated that contract, we were working our way through the lead ship. And so there were several items that we decided to leave with the government, decided to leave them as GFE for the second shift; that ultimately, down the road, what I would expect would become contractor furnished. But for 79, it's about the same.

Myles Walton - *Deutsche Bank - Analyst*

Okay. Thank you.

Operator

Ron Epstein, Bank of America.

Ron Epstein - *BofA Merrill Lynch - Analyst*

Mike, just maybe a big-picture question for you. When you think about your balance sheet and -- this is something we've talked a little bit about in the past -- how are you thinking about potential M&A going forward?

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

Well, I think our strategy that we laid out last -- at our investors conference last year, is the same. It hasn't changed. Our focus is on executing in our core business. We are looking to grow our services business in support of the Navy and the Department of Energy. If we have opportunities to do selected M&A in those areas, that would make sense to help us do those two things, then we would take a look at it. Quite frankly, what we are dealing with today is that -- we're always scanning and we're always looking.

Valuations are pretty high, and so it's kind of hard to come through the part where -- the first question we ask ourselves is, why are we the better owner? And it's challenging, given some of the valuations that are out there today, that we could really make the case that we are such a better owner that we would create the value that we'd need to create.

We're thinking about it. We're scanning for it. We're looking. But we also put in -- I think we communicated pretty clearly that we're not going to do M&A unless it meets our financial requirements, and we're going to be very disciplined about that.

Ron Epstein - *BofA Merrill Lynch - Analyst*

Just as a follow-on, are there any international opportunities? Or is that someplace you're not interested in?

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

I don't want to be terribly specific. But I think we're -- internationally, where it would make sense in support of our primary customer, is -- if it helps the US Navy do a better job somewhere, then we can think about that. But beyond that, I'm not so sure that we're terribly interested in that.

Ron Epstein - *BofA Merrill Lynch - Analyst*

Okay, great. Thanks, Mike.

Operator

Sam Pearlstein, Wells Fargo.

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

I was wondering if you could talk about the LHA TAO competition. And just -- first, is what is the impact of LHA-8? And then, second, the fact that Ingalls was awarded so many more hours on LX(R). That would imply you bid a lower cost. So I'm just trying to think about how that -- what that means for your cost structure versus your competitor. Or is it something about the margins that you're willing to accept versus them?

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

No. I think that there's a lot of variables in this competition beyond just the raw price shoot-out. The risk registers on the two programs were very different. The budgets that were allocated to those programs from the government side were very different. The capabilities of the competitors to execute the work was very different.

And so I think the confluence of all of those things together -- and there's probably a half a dozen other variables that go into it -- the confluence of all of those things drove the situation to come out the way that it did.

We're very happy with the way that it came out. I would certainly not draw the conclusion that we're willing to do something on the margins that is less than our competitors. I think that the blending of risk and cost and capability drove the decision to go the way that it did. And we're very happy with the way that this turned out, it obviously.

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

And if I can follow up on the CapEx, it continues to seem to ramp up at a slower rate than we always think. Are projects just getting pushed out? Is it that you are finding more efficiencies and you're not needing to spend as much as you thought? What's happening there?

Chris Kastner - *Huntington Ingalls Industries, Inc. - CFO and EVP of Business Management*

Sam, we spent $48 million in the quarter. We're at about 2.5% for the year. I still expect 3.5% to 4.5%. The projects are started and it's going to ramp towards the back end of the year. There are some large invoices and some large expenditures that are going to take place on some of these significant capital projects. So, projects are authorized; they're on schedule. It's just going to ramp throughout the year.

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

Thanks.

Operator

Jason Gursky, Citi.

Jason Gursky - *Citigroup - Analyst*

(multiple speakers) kind of explaining what's going to happen into the second half of the year at Newport News. I'm wondering if you could shift gears and maybe talk a little bit about Ingalls, and puts and takes that will transpire at Ingalls over that same time period.

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

Ingalls is in the crunch of ship delivery right now. There's a couple of ships that are going to trials and delivery between now and the end of the year, which is going to be very exciting for them. And it's going to be more of the same.

The big issue at Ingalls, frankly, with the execution that's going on today in serial production, the big issue there is capturing the next work: getting LPD-28 started, working our way through the acceleration of LX(R) and/or LPD-29, and getting LHA-8 off to a good start.

That's really the work that the team there will be trying -- they have to get that right in the next 6 to 9 months to set themselves up for the years after that. Without getting too far out in front of our headlights, we're doing really well there and we've got a couple of ship deliveries coming up, so we expect that we'll continue to do well.

Jason Gursky - *Citigroup - Analyst*

Okay. And then shifting gears back to the Virginia-class program, I know the wish list is to continue on at a rate of two a year. Can you just let us know, or help us understand when we will know for sure, from a funding perspective and a contract perspective, that that's what's actually going to happen? When do we need to see the funding from Congress? And when would we expect to see a contract into you guys that gives us some really good comfort that two a year is the plan?

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

Yes, I -- you kind of faded out there at the end, but I think you are trying to get at the two-per-year in the Virginia-class program, and when do we know for sure. And I've been around the business long enough that to believe that you don't ever really know for sure until you have a contract in hand.

The reality is that we're at two per year, and the next time that there was a plan to not be at two per year was in 2021, when we funded the -- when the government was going to fund the first Ohio replacement program ship itself, beyond the design.

And in this year's budget deliberation, that's the way the budget got presented to the Hill. The Hill said that they would really like to see a second submarine in 2021. The Navy said they'd like to see that, too. The industry said that would be great for us, too. So everybody agrees that having a second ship in 2021 would be a good thing.

I think the next time that you get to see whether that's actually made any progress, or not, is when the next budget gets submitted to the Hill in February or March of next year.

Now, I have mentioned to all of you -- I admit to being bit parochial and biased here -- but I do believe that when nations are challenged with the cost of their Navy, they build more submarines. And I believe that the pressure on submarines is always going to be up, not down. And so, I would expect -- I believe that we're going to be at two per year for as far as we can see. But each time we come up, where the next opportunity to drop to one moves inside the five-year plan, there's going to have to be things done to fix that. And so, you are seeing that happen on the 2021 ship now.

And it will be a couple of years before the next one has to be dealt with. That's the way I see it playing out. We're geared up and ready.

And the agreement on the Ohio replacement program anticipates that the delivery schedules for these ships will have to be adjusted to accommodate the delivery of the Ohio replacement. You've got to separate the budgeting process from the execution process. Budgeting is, how do you fit all of this stuff into an appropriation? The execution is, how do you actually deliver all those ships that have to deliver in the same year?

But the agreement on Ohio replacement actually anticipates that we're going to have some discussions about who's going to do what deliveries, to make sure that we get it all done. So I think the industrial base is working together really well on this. I think the Navy and the Congress are working together really well on this. And I'm very optimistic that we're going to be there for as far as we can see.

Jason Gursky - *Citigroup - Analyst*

Great. Thank you.

Operator

Pete Skibitski, Drexel Hamilton.

Pete Skibitski - *Drexel Hamilton - Analyst*

Real nice quarter. Mike, I'm just trying to think through -- I think the award for LPD-28 and NSC-9 are still set for the second half. You've got LHA-8 now, and LX(R) is in place. So I'm just wondering how you are thinking about your revenue visibility through 2020 that this point, just because it seems like there's an awful lot in place for you now. So I'm just wondering how you are thinking about that, and maybe if there's anything else that you need to fall into place.

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

Well, I think, first of all, you start talking about revenue in shipbuilding, you've got to figure out what's going to happen with sequestration and what's going to happen with how they pay for Ohio replacement program. We had a good situation this year in the budget request, in terms of things that needed to get done on the Ohio replacement are funded, and it did not affect any of the HII programs. The question is, is that going to be the case going forward?

And the visibility of around LX(R) is that we're doing more design work than we had a few months ago, before the award. But what we don't have right now is -- we need to either have that ship accelerated or we need to have another LPD in the line. And we don't have either of those right now, so visibility on that is still a little bit murky. So given all of that, I think we're going to stick with our forecast that, through 2020, our shipbuilding revenue is going to be relatively flat.

Pete Skibitski - *Drexel Hamilton - Analyst*

Okay. Understood, understood. Then just one follow-up. How are you feeling about the likelihood that we'll get an add from Congress on NSC-10 at this point?

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

There's a lot of support in the Congress for what the Coast Guard is doing, and there's a lot of success on what the NSCs are being able to provide to the Coast Guard. I think there's a lot of moving parts, but we remain optimistic and supportive of the program. So, we'll see how this end game works itself out, but that is certainly our objective.

Pete Skibitski - *Drexel Hamilton - Analyst*

Okay. Thanks, guys.

Operator

Robert Spingarn, Credit Suisse.

Robert Spingarn - *Credit Suisse - Analyst*

So Mike, when I look at Ingalls and I look over the last three years, the margins have ticked up from, call it, 10% in 2014 to 11% in 2015. This year is at 14.5%. You have characterized this business, even earlier on this call, as a 9% to 10% business. But you've also said you've got a lot of delivering ships here, and you are retiring risk at a rapid rate.

So with that as the backdrop, and with new ships coming, how do margins trend from here, rest of this year at Ingalls? And into next year, have you used up a lot of that EAC reserve? Is there any way for us to track this and measure it, and project going forward?

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

Well, I'd just remind you what we have said about the 9% to 10% range. If you are operating outside of that range, then for any period of time, you have to ask yourself why. If you are above the range, it probably means you have a lot of mature programs and you are harvesting pretty well, but the fundamental thing you need to be focused on is what's the new work. If you are below the range, you're probably doing a whole lot of new work, and you got to let those programs mature.

At Ingalls today we are very mature work going on in the LPD programs. The LHA-7 now has come along. The DDGs are coming along, and the NSCs are coming along all really well. The question in front of them is, okay, we're harvesting really well, but what's the new work look like?

So LHA-8 was a really big deal from that standpoint, because we really needed to have -- get through that and get that ship to under contract. We really need to get LPD-28 under contract. We need to sort out the LPD-29 and the LX(R) opportunity in the way that that plays out.

And we need to keep the destroyers on track. The destroyers pro comp at two per year is really important for us to keep that on track. So a lot of the activity at Ingalls, while we're doing really well executing, a lot of that activity is on the front end -- is on the new business piece of it.

In terms of handicapping the next quarter or the next two quarters, I just don't do that, because that's not the nature of our business. We have great quarters. We have lumpiness there. We will have lots of risk retirement in one quarter and not so much in the next, and so I'm a little reluctant to go there.

But in general, the focus is, what's the new were coming into Ingalls, so that we can maintain the healthiness of that shipyard.

Chris, you got anything you want to add to that?

Chris Kastner - *Huntington Ingalls Industries, Inc. - CFO and EVP of Business Management*

Yes. Rob, I will say the positive adjustment in the quarter at Ingalls was dominated by LPD-26. It had a really great delivery, and we were able to retire some risk there. I would not expect that over the balance of the year.

Robert Spingarn - *Credit Suisse - Analyst*

Yes, Chris, is there a way to quantify or to measure what's left in the reserve as we go forward for the various programs, just to give us a better sense of maturity levels and remaining opportunity?

Chris Kastner - *Huntington Ingalls Industries, Inc. - CFO and EVP of Business Management*

We don't disclose that type of information. It would be really tough to do, and really doesn't serve much of a purpose. We continue to believe that the 9% to 10% return on sales makes sense across the portfolio.

Robert Spingarn - *Credit Suisse - Analyst*

Yes, I think it does; it's just timing. And when you back out these EACs, you're closer to 6% this quarter, so it's obviously a hugely important element. So, anyway, I just wanted to throw that out there as something to think about.

I just had one other question, if I could. Given the ORP and the work split, with the majority going to the other yard, Mike, how do you think about any future opportunity to increase your work share on VCS? And does that maybe come into play with the multi-year being discussed?

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

Well, I think the agreement that we have is that we're going to shift some deliveries to Newport News during those times when we're trying to deliver the Ohio replacement platforms from Electric Boat. I think that's all part of the deal. How that gets quantified -- the first time you are going to be dealing with that situation is going to be after 2025. I think 2027 or 2028 will be the first time that that comes into play. And so, I'm not spending a whole lot of time right now trying to figure out exactly where that line gets snapped.

What we are trying to figure out right now is how do we invest in that program, and make sure that we can do it as efficiently as possible. And then we will see with the chips fall.

Robert Spingarn - *Credit Suisse - Analyst*

So, where you are of 50% player on submarines now, that will drop, at least in the early years here, during the development work on ORP. And it won't necessarily get offset until about 2025.

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

I don't know that -- if you look at the entire submarine industrial base, with the Ohio replacement program and the Virginia-class program, I'm not sure that I would go so far as to say that's a 50% program for us overall. I think it all depends also on what happens to the build rate on VCS. I'm okay with that, given that aligns with our work and aligns with our capital investment.

Robert Spingarn - *Credit Suisse - Analyst*

Okay. Okay. I wasn't implying that you were 50% on ORP; I'm saying you are 50% on VCS and less on ORP, and that you would average at a lower level when you put the two together. And is there an interest on Huntington's part to become a 50% player down the road, by raising your VCS share to offset the lower share on ORP? I know that was confusing, but I think you follow it.

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

I get it. And our only interest is working with our teammate and the Navy to make sure we produce these platforms as efficiently as possible. If we do that, then this will be -- it will be good for us and it will be good for the industry and it will be good for the Navy.

Robert Spingarn - *Credit Suisse - Analyst*

Okay. Thanks, Mike. Thanks, Chris.

Operator

Doug Harned, Bernstein.

Doug Harned - *Bernstein - Analyst*

Mike, as you are talking about investing in ORP, how do you -- I'm trying to get a sense of what the scale of that investment is, the investment that you're going to have to make, over the next few years. And then how you think about tying that in with some of the other investments, some of which you just named, and how this CapEx trajectory looks like. Are we looking at something in the 4% range for an extended period of time as you work through these new programs?

Chris Kastner - *Huntington Ingalls Industries, Inc. - CFO and EVP of Business Management*

Let me take that one, Doug. Yes, it's $1.5 billion over the next five years, and then ratcheting down to the 2% to 2.5%, subsequent to that. And included in that is the ORP investment.

Doug Harned - *Bernstein - Analyst*

And then separately, when you look at CVN-78 and the delivery, do you see much of risk of any post-delivery costs after that ship is delivered?

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

I think that depends, but I think it will be the normal situation that we have after a ship delivery. There may be some work that we will deliver the ship to go finish after the ship delivers. There may be some of that, but I think it would be on the margins.

Doug Harned - *Bernstein - Analyst*

So it's not something that you are particularly worried about, at this stage?

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

I'm not worried about that. To me, right now, the issue is can you get through the systems testing so that you have a full-up ship ready to go to sea when it's time to go to sea. That's what our focus is on. And we're -- the team is working really hard to make sure we have that done.

The ship will go -- it will go to sea; it will do some qualifications after delivery. Eventually, it comes back in for a post-shakedown availability. And there's already being stuff identified today that is stuff that we're going to want to do during that time frame. So that work package is already being worked on.

So, no. Doug, that's just the normal way that these ships joined the fleet. They go through this pretty turbulent period to become part of the greatest fleet in the world. And so, this is all part of getting them ready to do that.

Doug Harned - *Bernstein - Analyst*

But presumably, once -- if you have nailed this on delivery -- well, that's the key here. There's probably not a huge risk of residual costs down the road, post-delivery.

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

Delivery is a big event; there's no doubt about it, from a cost standpoint.

Doug Harned - *Bernstein - Analyst*

Great. Thank you.

Operator

David Strauss, UBS.

Unidentified Participant

It's actually Matt on for David. I was wondering if you could comment about your UPI business. It looks like the loss rate there has been relatively stable. When do you think that business can get back to breakeven? And what has to happen to get there?

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

Well I think -- obviously the business itself is being dramatically affected by the environment that it's in. We are waiting to see the capital projects get turned back on by their key customers. They have continued to win work. And our strategy of preserving capability to stay close to those customers is working. But the work that they've won doesn't really kick in until the end of this year, or the beginning of next year. Just like that whole industry, everybody is trying to figure out, how's the best way to survive. And we're working with them to make sure that we do that.

As far as the timing goes, I didn't know the timing of this business before we got into it, so I'd be the last person you should be asking about the timing now.

Unidentified Participant

Right. Okay, thanks. And then just one more on tax rate. Where do you see tax rate beyond this year? Is a much different from 2016, ex- the Q1 benefit?

Chris Kastner - *Huntington Ingalls Industries, Inc. - CFO and EVP of Business Management*

Yes, so, 30% to 32% for the year [dominate or] the reduction related to the stock comp deduction that rolls through the income statement instead of how it used to go through the balance sheet. As you get less stock options, or equity vesting, that could raise a bit. So, I think this is probably as low as it gets, and it could go up from here. But we'll give you more visibility when we do the year-end call.

Unidentified Participant

Sure. Okay, thank you.

Operator

Noah Poponak, Goldman Sachs.

Noah Poponak - *Goldman Sachs - Analyst*

Is the risk to Newport News that you've highlighted in the back half such that the framework needs more net positive cumulative catch-up adjustments at Ingalls, whereby that total nets out to a 9% or slightly better shipbuilding segment margin? Or is it more Newport News is a little below 9%, Ingalls a little above 9%, and you'll see what happens with positive cumulative catch-up adjustments.

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

Well, we do these adjustments when we evaluate EACs and when we retire risk. And so they come about the way that they come about. We certainly believe that over time -- this is why we don't try to do this on a quarter-by-quarter basis, because in any given quarter, they may not match. But over a period of time, they will match. And so our sense of it today is that our shipbuilding business will be in the 9% to 10% range over a reasonable amount of time.

We have described in some detail today that over the next 12 to 18 months, Newport News is grinding on that a little bit. And right now Ingalls is doing really well. We don't see that being dramatically different. But it's important for Ingalls to get that new work in. And it's important for Newport News to be successful in grinding through these deliveries. So that's what we're focused on.

Noah Poponak - *Goldman Sachs - Analyst*

Okay. Yes, I ask less -- is not an effort to ask for timing of cume catches; it's more, is the Newport News risk in the back half you've highlighted such that you would need those in the back half to be at 9% or not, if that makes sense.

Chris Kastner - *Huntington Ingalls Industries, Inc. - CFO and EVP of Business Management*

We're going to have to come through the risk retirements on all the programs every quarter. We'd hate to handicap that.

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

Yes.

Noah Poponak - *Goldman Sachs - Analyst*

Okay. Is the hesitation in quantifying pension contribution beyond 2016 simply the uncertainty around the timing of a mortality table change? Or is it really many moving pieces that have wide ranges of possible outcomes?

Chris Kastner - *Huntington Ingalls Industries, Inc. - CFO and EVP of Business Management*

You said that very well, actually. It's really -- of the first one is the most significant. The new mortality tables would increase contribution significantly. But there are a lot of moving parts, as we all know. So, best not to speculate, and just do the analysis throughout the year, and let you guys know at the year-end call.

Noah Poponak - *Goldman Sachs - Analyst*

Okay. I think a lot of people in the investment community are coming up with large ranges of guesses on that use of word significant for the mortality piece. So I didn't know if you guys had been able to, at this point, hone in on some kind of order of magnitude range of that compared to the baseline, or not.

Chris Kastner - *Huntington Ingalls Industries, Inc. - CFO and EVP of Business Management*

Not at this point.

Noah Poponak - *Goldman Sachs - Analyst*

Okay. And then just from there, you have a stated plan to return substantially all the free cash to shareholders. Can you just speak to -- I guess that's theoretically inclusive of a pension contribution. But is there a scenario where you can still do that on a pre-pension contribution basis? Just because the cash generation is so consistent, and the leverage is pretty low. Or is that not in the scenario analysis? Or is it somewhere in between? If you could just speak to how those ultimately tie together.

Chris Kastner - *Huntington Ingalls Industries, Inc. - CFO and EVP of Business Management*

Well, that's not in the scenario analysis. Pension rolls through free cash. So subsequent to that, we will return substantially all of our free cash flow to shareholders, in the form of at least a 10% annual increase in our dividend, and the rest being share buybacks. So, the way the policy reads and the way we have communicated it is pension actually rolls through free cash.

Noah Poponak - *Goldman Sachs - Analyst*

Okay. Okay. Thank you.

Operator

George Shapiro, Shapiro Research.

George Shapiro - *Shapiro Research - Analyst*

Yes. In the first quarter, the Q, you disclosed there was a $22 million EAC gain on a contract, which I assume was LPD-26. Was that comparable this quarter? And since you delivered the LPD-26 this quarter, is there that kind of upside on LPD-27 going forward? Thanks.

Chris Kastner - *Huntington Ingalls Industries, Inc. - CFO and EVP of Business Management*

George, the majority -- or the most significant nonrecurring adjustment in the quarter was LPD-26 delivery. You are 100% correct there. We will have to see on LPD-27. That was a separately negotiated contract. And we have to come through the risk retirements as we approach delivery on that ship, which will be mid- next year. So, a little bit early on 27; we will have to assess that as we come through the process.

George Shapiro - *Shapiro Research - Analyst*

And will the Q disclose the value of that, like it did in the first quarter?

Chris Kastner - *Huntington Ingalls Industries, Inc. - CFO and EVP of Business Management*

I believe it will, yes.

George Shapiro - *Shapiro Research - Analyst*

Okay. Thanks very much.

Operator

At this time, I'm showing no further questions.

I would now like to turn the call back over to Mr. Mike Petters for closing remarks.

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

Well, thanks to all of you for joining us on the call today. We really appreciate your interest in our Company. We're excited about what we've done so far, and we're really excited about the future that we're building for this organization. So we look forward to continuing our conversation throughout the quarter, and we'll see you on the waterfront. Thank you very much.

Operator

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