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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Huntington Ingalls Industries third-quarter 2015 earnings call.

(Operator Instructions)

As a reminder, this conference call is being recorded. I would now like to turn the call over to Mr. Dwayne Blake, Vice President of Investor Relations. Please go ahead, sir.

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

Thanks, Amanda. Good morning, and welcome to the Huntington Ingalls Industries third-quarter 2015 earnings conference call. With us today, are Mike Petters, President and Chief Executive Officer, and Barb Niland, 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 Barb will refer to certain non-GAAP measures, including certain segment and 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 third-quarter 2015 financial results that reflected solid operational performance. For the quarter, revenues of $1.8 billion were approximately 5% higher than last year, and diluted EPS was $2.29, which included one-time costs of $0.06 per share for the full repayment of our term loan. Backlog at the end of the quarter was approximately $23 billion, of which $12.5 billion is funded.

Demonstrating continued confidence in the free cash flow generation of the business, our Board of Directors recently approved a 25% increase in our quarterly dividend to $0.50 per share, and doubling our share repurchase program from $600 million to $1.2 billion. These decisions reaffirm our commitment to continue returning cash to our shareholders.

Since our Q2 earnings call in August, Congress passed the FY16 National Defense Authorization Act, but the bill was vetoed by the President and returned to the Congress. Last week, a budget compromise was reached between the executive and legislative branches, which provided temporary relief to sequestration by raising the budget caps in FY16 and FY17 for defense and nondefense discretionary accounts. We believe that the budget levels in the agreement pave the way for a corresponding adjustment in defense authorization levels that will ultimately enable enactment of a revised bill.

Similarly, the budget agreement should allow for final passage and enactment of defense and nondefense appropriations measures. We remain hopeful that authorization and appropriations bills will be enacted in a timely fashion to minimize disruption to the industry. At the same time, our team remains engaged with Navy and congressional leadership on all of our programs.

Now I will provide a few points of interest on our business segments. At Ingalls, the NSC program continues to perform extremely well, as the team launched NSC 6 Munro in September, and is expected to be delivered by the end of next year. In addition, fabrication started in July for guided missile destroyer Delbert D. Black DDG119, the 32nd Arleigh Burke-class destroyer to be built at Ingalls.

At Newport News, the Virginia-class submarine program continues its outstanding performance, as the team achieved the pressure hull complete milestone on Washington SSN 787 in September, signifying that all of the submarines hull sections have been joined to form a single watertight unit. Washington will be the US Navy's 14th Virginia-class submarine, and the 7th to be delivered by Newport News.

On Gerald R. Ford, CVN-78, the overall test program continues to supports delivery in the first half of 2016. However, increased vendor service costs required to support troubleshooting and repair of various systems during the test program, caused us to increase the estimated cost to completion, and recognize a negative cumulative adjustment in the quarter.

While it is a bit disappointing that we had to recognize a cost increase for the second quarter in a row, we are less than a year of delivery, and the Newport News team is focused on completing the work on this first of class ship in a safe and high quality matter. And regarding UniversalPegasus, weakness in the oil and gas market remains a challenge, but we are continuing to make the difficult decisions to position the business for the market turnaround.

In closing, the relentless focus on program execution, risk retirement, and cash generation, continues to serve us well and remains a top priority. As the result, the team produced solid financial results this quarter, that keeps us on track to maintain 9%-plus operating margin in our shipbuilding business.

Now that concludes my remarks, I will now turn the call over to Barb Niland for some remarks on the financials. Barb?

Barb Niland *- Huntington Ingalls Industries Inc. - Corporate VP, Business Management & CFO*

Thanks, Mike, and good morning, everyone. Today I will review our third-quarter consolidated and segment results, as well as provide you with a few updates for the full year. Please refer to the slides posted on our website for more information.

Turning to the consolidated results on slide 4 of the presentation, total revenues in the quarter of $1.8 billion, increased $83 million or 4.8% from the same period last year, due to increased volumes at Newport News and Ingalls. The increase was partially offset by lower volumes at UPI. Segment operating income of $172 million increased $21 million, and segment operating margin of 9.6% improved 76 basis points from the third quarter of last year due to the strong performance at Ingalls.

Total operating income of $200 million increased $29 million, and total operating margin of11.1% improved 115 basis points from the same period last year, due to performance improvement at Ingalls, and an increase in the FAS/CAS adjustment.

Cash from operations was $254 million, and free cash flow was $217 million, which was consistent with the third-quarter 2014. Capital expenditures in the quarter were $37 million, compared to $40 million in the same period last year.

As I mentioned, during last quarter's call, we have been seeing lower-than-expected capital spending this year. Some of our larger projects started later and slower than planned. And so, now we expect capital expenditures as a percentage of revenues to be approximately 2.5% for the full year. We will provide you with more details on our capital expenditure expectation during our Investor Day on November 10.

During the quarter, we repurchased approximately 915,000 shares at a cost of $103 million, and paid dividends of $0.40 per share or $19 million. As I mentioned on last quarter call, we repaid our outstanding term loan, bringing our third-quarter cash balance to $671 million.

Moving onto the segment results, beginning on slide 5 of the presentation, Ingalls third-quarter revenues of $593 million increased $34 million or 6.1% from the same period last year. The increase was driven by higher volumes on the DDG and the LHA programs, partially offset by lower volumes on the LPD and NSC programs. Operating margin for the quarter was13%, a 315 basis point increase over the same period last year due to performance improvement on the LHA, NCS and LPD programs.

Turning to slide 6, Newport News third-quarter revenues of $1.2 billion increased $80 million or 7.3% over third-quarter 2014, due to higher volumes on the VCS program and in fleet support services. This increase was partially offset by lower volumes on the CVN-72 RCOH, and the construction contract for CVN-78. Operating margin for the quarter was 8.5%, a 71 basis point decrease from the third quarter last year due to lower performance on CVN-78.

Moving on to the other segment, revenues in the quarter were $30 million with an operating loss of $5 million due to the prolonged weakness in the oil and gas services markets.

Now to update you on some items for the full year. We are now estimating a FAS/CAS adjustment of the $106 million, which is slightly lower than our previous estimates due to updated census data. Additionally, we now expect deferred state income tax expense of approximately $3 million, instead of the $5 million benefit I provided on the first quarter call, due to timing of contract income for tax purposes, and the impact of the true-up of 2014 estimated taxes to actual filed returns. We still expect interest expense, excluding the one-time costs associated with bond refinance and the term loan repayment, to be approximately $95 million.

Turning to slide 7, where we have included some sensitivities around 2016 FAS/CAS adjustment. Please remember that pension-related numbers are subject to year-end performance and measurement criteria, and therefore we will provide you with a better estimate for 2016 on our fourth-quarter call. But this chart shows the sensitivities of 2016 estimated FAS/CAS adjustment to discount rate assumptions, and actual asset returns for 2015, and assumes 7.5% long-term return on assets going forward.

At the end of the third quarter, our discount rate was approximately 25 basis points higher than last year, and year-to-date actual asset return was negative 3.3%. Therefore, depending on the year-end performance, the measurement criteria, and the discount rate, 2016 FAS/CAS adjustment may vary significantly from the sensitivity shown on this chart. But again, we will provide you with an update during our fourth-quarter call.

To summarize, this was a good quarter, led by strong performance at Ingalls. However, as I often try to remind you, that from quarter to quarter, shipbuilding can be operationally lumpy due to the portfolio mix of new and established programs, the timing of milestones, risk retirements and deliveries. With that being said, we may remain on track to meet our full year 9%-plus segment operating goal in our shipbuilding business.

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, Barb. 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. Amanda, 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*

Thanks, good morning, and great results.

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

Thank you.

Barbara Niland - *Huntington Ingalls Industries Inc. - Corporate VP, Business Management & CFO*

Thank you.

Gautam Khanna - *Cowen and Company - Analyst*

I was wondering if you could just comment on, in the defense compromise, that bill that's pending, what you saw that may have been upside or a positive development? And if you saw anything that was a little bit less positive?

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

Well, first of all, I'd say, remember the horizon of this business is pretty long-term. And so, the -- any particular movements in any particular piece of legislation are probably less significant to us. Rather than, and instead I would say, the act -- the fact that they got a compromise, and the fact that they are moving towards a regular order process to get through a revised authorization bill, and get these appropriations bills done, and we are optimistic that that's going to happen.

We believe that the more the legislative process can be, in a regular order process, the better chance we've to make a case for the long-term investments that need to be made to support our programs. When we are in a sequestered environment, that's a very short-term, very narrow focus, and it can have some long-term affects. And so, we're very, very happy that we've a compromise, and we're optimistic that we will get through the appropriations process. But we're paying very close attention to make sure that happens. In terms of our programs, they're all very well-supported -- they were very well-supported in the first authorization bill, and we expect that to continue.

Gautam Khanna - *Cowen and Company - Analyst*

Okay. And then, if I could just ask a follow-up. At Ingalls, obviously, you've had terrific results for a while now. And just want to get a sense for -- I mean, is there anything that gives you pause, that would potentially slow that down as you move forward, in terms of just how the ship flows through? I mean, how unusual would you say this quarter was, relative to what we could expect going forward?

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

Well, I'd say, we've talked before about these businesses are a balance between work that's happening on mature programs, and work that you are starting up on. We are very, very pleased and really proud of the team at Ingalls, and what they've accomplished in, since we spun the company. But even going further back they have really rebooted that business to where it's today.

But I think the balance between -- work and retiring risk on mature programs, and starting up new programs causes what Barb calls the lumpiness in the business. And that's why we say, the healthiest range for the business is to operate in the 9% to 10% band. Where we are today -- as opposed to where we were in 2011, where we had a significant number of mature programs at Ingalls that were performing way below our standards. Where we are today, is that our programs that we are executing on are performing to our standards.

The challenge at Ingalls is, how do you parlay that into future work? The real challenge that we see at Ingalls over the next five years is going to be, what's next? The LDP-28 is an example of, let's keep the production line hot, let's get that program moving, let's bridge the LPD program success that we've created into the next class of amphibs.

Let's keep the destroyer program on track. Let's keep the NSC program moving. There is talk of a NSC 9, and we are very supportive of that. So the thing that I would say on the horizon for Ingalls is, number one continue to focus on superior execution. Number two, let's go capture that new work that's out there.

Barbara Niland - *Huntington Ingalls Industries Inc. - Corporate VP, Business Management & CFO*

I would also add, for this quarter, we had some favorable adjustments on the LHA 6, which was previously delivered. So we cleaned up some contract changes and better performance on some deferred work. So that also helped increase the Ingalls margins for this quarter.

Gautam Khanna - *Cowen and Company - Analyst*

Got it. Thank you very much.

Barbara Niland - *Huntington Ingalls Industries Inc. - Corporate VP, Business Management & CFO*

Thank you

Operator

Pete Skibitski, Drexel Hamilton.

Peter Skibitski - *Drexel Hamilton - Analyst*

Good morning. Nice quarter.

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

Good morning.

Barbara Niland - *Huntington Ingalls Industries Inc. - Corporate VP, Business Management & CFO*

Thank you.

Peter Skibitski - *Drexel Hamilton - Analyst*

Hey Mike, on this news out there in the quarter, that postulated a workshare for you of roughly 40% on SSBN(X). Anyway you would comment on whether or not that's in the ball park of what you are expecting for the production contract, and whether development would be on that order of magnitude as well? Any color you could give on that would be great?

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

In the short, the short answer is no, I don't have a comment on that. The broader answer is what we've said before, we are working closely with the other members of the submarine industrial base, and the US Navy to try and find the very best way for the nation to produce the Ohio replacement program, at the same time that it's producing the Virginia-class program.

The submarine industrial base has shown that it's been able to do that in a very, very efficient and effective manner, and we are working our way through that now. And so, more to come. We will negotiate that, and then come back, and let you know how it all turned out.

Peter Skibitski - *Drexel Hamilton - Analyst*

Okay, great. Just one follow-up. On DOD's decision to do a live fire testing on the Ford, is there any financial impact to you from that, either positive or negative?

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

Not that I would hazard to put any programmatic estimate on. I mean, we would probably be involved in trying to set up, and also trying to evaluate. But the bigger issue there, I think fundamentally the bigger issue there is, when is the ship going to be ready to deploy? And this is going to change that schedule. And just in the past few days, we've had members of the Navy telling Congress that they are short aircraft carriers. And so, I think that's a bigger issue for the Navy than it is for us.

Peter Skibitski - *Drexel Hamilton - Analyst*

Okay. Got it. Thanks very much.

Barbara Niland - *Huntington Ingalls Industries Inc. - Corporate VP, Business Management & CFO*

Thank you.

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

Thank you

Operator

Sam Pearlstein, Wells Fargo.

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

Good morning.

Barbara Niland - *Huntington Ingalls Industries Inc. - Corporate VP, Business Management & CFO*

Good morning, Sam.

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

Can you talk a little bit about capital? And where I'm going with this is, one, what should we think about as the ongoing quarterly interest expense now with the refinancing? And then secondly, given that you got probably a better than expected rate, why didn't you borrow more, buy back stock more aggressively? How are you thinking about capital, because it seems like you certainly could have borrowed more to do something like that?

Barbara Niland - *Huntington Ingalls Industries Inc. - Corporate VP, Business Management & CFO*

Okay. So, I will start with the interest expense. After this year, we'll expect to see about a $12.8 million savings related to that bond refinancing going forward, so for the year, okay? As far as -- you asked about capital expenditures -- or you just want to talk about -- ?

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

No, no, capital allocation. Like why not take advantage of the lower rates, and maybe do more in terms of the repurchase? I know that the Board just added the authorization -- not capital expenditures, but thinking about the capital of the business?

Barbara Niland - *Huntington Ingalls Industries Inc. - Corporate VP, Business Management & CFO*

We are going to talk more about that on Tuesday at our Investor conference. So we'll -- can we hold that question until then?

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

Okay.

Operator

Robert Spingarn, Credit Suisse.

Barbara Niland - *Huntington Ingalls Industries Inc. - Corporate VP, Business Management & CFO*

Good morning, Bob.

Robert Spingarn - *Credit Suisse - Analyst*

Barb, could you just go through what you said a moment ago about the puts and takes, or EACs if you will in the two businesses? You talked about LHA 6, and the magnitude of that, and any other major positives or negatives at either business?

Barbara Niland - *Huntington Ingalls Industries Inc. - Corporate VP, Business Management & CFO*

Sure. So we had $82 million of gross favorable adjustment in $20 million of gross unfavorable adjustments. So net adjustments were $62 million for the quarter. So some of the usual suspects: VSC was a positive adjustment or a favorable adjustment. I talked about LHA 6, NSC programs, some favorable adjustments. And on CVN-71, we had some outstanding contract resolutions. And on the unfavorable side, it was the CVN-78 and a couple nits and gnats, none individually significant

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Robert Spingarn - *Credit Suisse - Analyst*

Okay. Thanks for that.

Mike, with CVN 78, it sounds like there are cleanup items ongoing. Barb just mentioned them. How much longer might we expect to see that at this stage, given that you are so close to the end?

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

Yes, I meant the ship is essentially built, and where we are now, is we are taking all that -- all of those new systems and we're testing the systems -- kind of testing each of the systems out, but we're also testing the integration of the systems with each other. Significant amount of new technology in the program, significant amount of software associated with these systems. Some of it is contractor furnished that we've been responsible for; some it is government furnished that the government has brought the system to us, and now we have to integrate into the ship and test it.

This is the romance of our business, is that the test program is designed to iron all of this stuff out. It's really hard to predict how these things are going to go. The team is working really hard to work its way through that. The main thing though, is that the schedule is holding, and we are on track to deliver the ship in the first half of next year.

And so, from that standpoint, I think that that sort of puts a boundary on the time frame of the impact of this program to where we are. We are very disappointed that we -- that this has played out the way that it has. But at the same time, we recognize that it's a lead ship, and it's still the best lead ship program I have ever been associated with. So from that standpoint, it's still going pretty well.

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Robert Spingarn - *Credit Suisse - Analyst*

Okay. And then, just Barb, a clarification. You talked about the volatility in the margins, we understand that. But the implied fourth quarter for Ingalls is pretty low at that 9% full year number. Is there anything we should interpret from that?

Barbara Niland - *Huntington Ingalls Industries Inc. - Corporate VP, Business Management & CFO*

Well, I just want to remind everybody, the LHA 6, the big adjustment that we made this quarter made the margins pop. So -- (multiple speakers)

Robert Spingarn - *Credit Suisse - Analyst*

Do we go back to normal, or do we go back to lower than normal?

Barbara Niland - *Huntington Ingalls Industries Inc. - Corporate VP, Business Management & CFO*

You are killing me, you're killing me (laughter).

Robert Spingarn - *Credit Suisse - Analyst*

Not trying to.

Barbara Niland - *Huntington Ingalls Industries Inc. - Corporate VP, Business Management & CFO*

I will go back with, hey, by the end of the year, we will be at 9%-plus in our shipbuilding business. How about that?

Robert Spingarn - *Credit Suisse - Analyst*

Okay.

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

I'll go back to what we've always talked about. If you try to predict where any one of these things is going to be, in any particular quarter, that's a bunny trail that we really don't recommend you go down. You have to look at the aggregate of the business over a four-quarter period, and see how that all smoothes itself out.

Ingalls is doing really well, there is no doubt about that. That's not to say that Ingalls is going to always have every quarter be like this quarter has been. We are trying to make sure that you don't -- that you understand that there's some one-time things in this quarter that they've earned, but they show up in our accounting this quarter.

Robert Spingarn - *Credit Suisse - Analyst*

Okay. Thanks.

Operator

Doug Hamed, Bernstein Research.

Finbar Sheehy - *Bernstein Research - Analyst*

Good morning, it's actually Finbar here for Doug.

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

Good morning.

Finbar Sheehy - *Bernstein Research - Analyst*

Good morning. A couple things, short. On Newport News, you announced layoffs earlier in the year, because of the phasing and scale of the work coming up. Are you at the right level now, or done with that, or where do we stand with that?

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

Now, this is just the first phase of that. Remember the cause of this is, it's because we have three aircraft carrier deliveries in a very narrow window. I think it's now -- we are now down to -- I think it's about 15 months now, we are going to be delivering three carriers.

And truthfully, some of that has been -- was caused by the budget battle back about three years ago, when the arrival of the overhaul was delayed due to a congressional dispute. But because we are going to be working through that over the next year and a half, we are going to have another round of this next year, that we're going to have to recognize. The saddest part of it all is that on the other side of this, when we start heavy work into the buildup of the Kennedy workforce, and the buildup of the Ohio replacement workforce, we are going to want to hire a lot of the folks back.

And that's the problem that we have, when we get a little bit out of phase, is that this coming and going is not healthy for the business. It tears our heart out that it we have to go through this, and we try to move mountains to prevent it, and our legislators try to do that, too. It's just incredibly unfortunate that we are actually going to have to go through this little dance over the next couple of years.

Finbar Sheehy - *Bernstein Research - Analyst*

I mean, given the pressure on volumes, the presumably the layoff costs associated with that, and then re-hiring and retraining, I mean are we looking at pressure on the margins there, for some time to come from this?

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

Well, I think it's fair to say, that the blended balanced shipyard operates in the 9% to 10% range. I think, all in all, across the industry, Newport News has a very bright future, but they are going to have to work through some pretty tough issues in the next 18 months.

Finbar Sheehy - *Bernstein Research - Analyst*

Okay. Thanks.

Operator

Myles Walton, Deutsche Bank.

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

Hello?

Barbara Niland - *Huntington Ingalls Industries Inc. - Corporate VP, Business Management & CFO*

Myles?

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

Okay, it looks like we lost him. We will move onto the next question.

Operator

Jason Gursky, Citi.

Jason Gursky - *Citigroup - Analyst*

Yes, good morning, everyone.

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

Morning.

Jason Gursky - *Citigroup - Analyst*

Hello. Congratulations on the retirement by the way. Can you just give us a quick update on the Avondale negotiations with the Navy, expected timing, and whether you've gotten any feedback from them on your proposal?

Barbara Niland - *Huntington Ingalls Industries Inc. - Corporate VP, Business Management & CFO*

Yes, we did get a feedback with a lot of question cost this past quarter, and we are working with them. We've answered all of their questions, and we are waiting to hear back them. So as I've said before, this will be a process, and it's a continuous negotiation and providing more data that support the costs in our proposal. So no real big change, other than they gave us some questions, we answered the questions, we're waiting to hear back.

Jason Gursky - *Citigroup - Analyst*

And Barbara, is there any statutory time lines on this, or is it just an open-ended negotiation and it's done when it's done?

Barbara Niland - *Huntington Ingalls Industries Inc. - Corporate VP, Business Management & CFO*

Actually, we have a statutory requirement at the -- next year, sometime next year. And so, we will either have to extend it, or settle it, or if we are in total disagreement, take it to claim. So but, I am optimistic that we will work together with our customer, and have a resolution that meets our expectations.

Jason Gursky - *Citigroup - Analyst*

Okay, great. And then, Mike, for you, on the CapEx side of things, we are running a little bit lower than what was expected for this year. What does that say about margin rates over the next couple of years? I know that some of this CapEx was going go towards things that were going to help improve your cost structure, and your ability to perform over the longer term. Does a lack of a ramp in CapEx this year push out the potential positive impacts of that capital?

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

Yes, we've not ever really said that this capital was going to improve near-term margin. This is really -- I think I've characterized it as generational investment in our Business, and it's really about the long-term support of programs over the next couple of decades. So the time phasing that you are seeing now, is really driven by our analysis of the project, where it stands. And then, how do you bring that project into -- how do you start that project up in a way, that's not terribly disruptive to the work that you've already got going on.

And so, it's a pretty massive planning job, to think your way through. I am building the most complex warships in the world, and now I'm going to redo the facilities, or create new facilities while I continue to build the most complex warships in the world. And so, we're very thoughtful about that, before we cut the money loose, to go and invest in the project Because once we cut it loose, that's -- it's too late to go back at that point.

So we are doing a lot of analysis, we're doing a lot of study, a lot of planning, a lot of interaction with all of our program folks, and all our customers, to make sure that we keep everything we've got on track, but that we can effectively and efficiently cut in the programs, or cut in the projects in a way that they will support the programs as best as they can. So there is a lot going on here, but it's -- I think it's evidence of the thoughtfulness that's going into these investments.

Jason Gursky - *Citigroup - Analyst*

That's great. Thank you.

Operator

Ron Epstein, BofA.

Ron Epstein - *BofA Merrill Lynch - Analyst*

Hey, good morning, guys. Good morning, Mike.

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

Good morning.

Ron Epstein - *BofA Merrill Lynch - Analyst*

Big picture question for you. As you think about the future of the business, you made one move to diversify into the oil engineering services stuff that didn't really play out. Do you think about other ways to take the business and to diversify in some -- away from just the large shipbuilding or forever more is the business is a shipbuilding business?

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

Well, Ron, we are going to talk about this at some length on Tuesday. Let's just say that I still think there are a lot of capability in our Business and there are customers out there that need it. And so, to trying to find the right business arrangement that allows that kind of access to happen, is something that we believe needs to happen.

And so, like I said, we will talk on Tuesday a lot about who we think those customers are, and how we plan to kind of think our way through that. But, yes, I still think it's important for this Business to not be so focused in on one single customer and one single approach. Because frankly, there are a lot of people out there who do a lot great things, and that we can learn from. And we do a lot of great things that they can learn from us, and so that's what's going to I think, ultimately create more value in this Business.

Ron Epstein - *BofA Merrill Lynch - Analyst*

Okay, great. And maybe one follow on, kind of related. When we -- when you look out over the next year or so, what other opportunities are there right now within the core business, that you are looking to pitch at, or that they are on the horizon?

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

Well, I think the -- if you take a look at this business over the next 5 or 10 years, the single most important issue in front of the industry, not just us, but the industry, is how is the Navy to pay for the Ohio replacement program? If that money, if the money for that program is going to be paid out of the traditional shipbuilding account, at the traditional levels, then a lot of other programs are going to be affected. On the other hand, if there is way for that program to be funded, either outside of the shipbuilding account or above the shipbuilding account, then you have a chance for the industry to remain healthy in support of all of these programs that the Navy needs.

And so, when I step back -- there is probably a lot of things. We've done some technology investment in undersea warfare. We bought a undersea systems group that brought some technology to us, and we're interested in those kinds of things. And you can stack all those programs up, but at the macro level, the most important issue facing the industry today is, how is that Ohio replacement program going to be funded? It has to be done. Its a national priority. I am a little biased, I was a boomer sailor myself, when I was back in the Navy, but it is something that the nation is going to do. And so, the question is now, how do you do that, and still do all of the other things that we need to be able to get done?

Ron Epstein - *BofA Merrill Lynch - Analyst*

Okay, great. Thank you so much.

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

You bet.

Barbara Niland - *Huntington Ingalls Industries Inc. - Corporate VP, Business Management & CFO*

Thank you.

Operator

(Operator Instructions)

Darryl Genovesi, UBS.

Darryl Genovesi - *UBS Securities LLC - Analyst*

Hello. Thanks for the time.

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

You bet.

Barbara Niland - *Huntington Ingalls Industries Inc. - Corporate VP, Business Management & CFO*

Good morning.

Darryl Genovesi - *UBS Securities LLC - Analyst*

Hey, Barb, when I look at your pension slide on page 7, it shows a downward variation of the FAS/CAS income with an upward variation in the discount rates. I think that's opposite to what we are accustomed to seeing. Can you explain what is going on there?

Barbara Niland - *Huntington Ingalls Industries Inc. - Corporate VP, Business Management & CFO*

Right. Well, what we did on this chart, is we assume that FAS and CAS move equally. So we probably should have footnoted that on there. So when you think about it, when the discount rate goes up, your expense goes down. So well, that's the nuance here. We just assumed that FAS and CAS move equally.

Darryl Genovesi - *UBS Securities LLC - Analyst*

Okay.

And Mike, if I can just ask you a bigger picture question that admittedly is probably better suited for Tuesday. I mean, you've talked a few times about -- in fact, you talk very frequently about shipbuilding businesses doing 9%, 10% EBIT margins through the cycle. When I compare that to other defense businesses, I mean, we've seen margins at other defense [primes] move up pretty significantly over the course of the last cycle. A lot of them are doing 12%, 13% EBIT margins these days. And I just wonder if there is something that's structurally different about shipbuilding, that you think that makes it an inherently lower margin business than say, aircraft or armored vehicles, or whatever the case may be?

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

Yes, that's a really good question. It's sometimes disconcerting to see the challenge for the businesses that are so capital intensive, to be in a second tier of margin relative to some of the other programs in the Business. But when I step back, and think about why that is, I think that there is probably two things that don't get a whole lot of attention. One is, a lot of those businesses that are at higher margin, they have actually done some of the same things that we do. They are in serial production of their product, they just have lots of products.

And so, even in shipbuilding, where we are able to get into serial production in our programs, we are able to drive our margins, and drive our investment plans to perform very well. The challenge that this Company has is that, a significant part of our Business is not really -- doesn't really allow for serial production. I mean, serial production in aircraft carriers is -- yes, I mean we optimize that, if we can be build them three or four years apart, but that's not the way they are being bought right now. And so, that create risk in the program that doesn't exist if you are producing hundred planes or an assembly-line kind of operation. So that's one part of it.

But the other side of it is, that the capital investment that we make in our Business has a much longer life I think, than the capital investment that gets made in some of those other businesses. These great companies that build these high-performance platforms for the Department, they are inserting technology in their assembly lines, and into the product, and they are making that investment, and they are getting that return because they have multiple products, they are getting that return pretty fast.

For us, we are make a pretty substantial capital investment in our business that's going to play out over the next 25 years. So there is a pace to this business that's a little bit different. And as a result, I think that our customer is able to go, and say, here is where I want to go over the next 30 years. 30-year plans change sort of the risk profile of the industry. And so, I think all of those things, sort of conspire together to create a situation where the healthiest part of our business -- the healthiest business for us is in the 9% to 10% range. We are certainly going to have quarters where we are above that, and we're going to have quarters where we are below that. But I think that over a 30-year period, if a shipbuilding enterprise operates in the 9% to 10% range, that's a pretty good business.

Darryl Genovesi - *UBS Securities LLC - Analyst*

That's great color. Thanks a lot.

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

You bet.

Operator

George Shapiro, Shapiro Research.

George Shapiro - *Shapiro Research - Analyst*

Yes, just a couple quick ones. On the Ingalls margin, Barb, would it be fair to assume that since that the pickup came from primarily the LHA 6 -- and that was one of your last underperformning ships, that the likelihood of getting those pickups in the future is low, and that's why you're saying, it's -- a lot it's nonrecurring?

Barbara Niland - *Huntington Ingalls Industries Inc. - Corporate VP, Business Management & CFO*

(laughter) I am not saying it's impossible, that the future you will see a large pickup, or a pickup to that extent. But Ingalls, like we said, is doing very well, all the ships are performing very well. We have a very methodical approach to risk retirement on all our ships, both at Newport News and at Ingalls. And this just happened to be some contract changes, completing a couple things on LHA 6 that gave us a nice little pop there.

George Shapiro - *Shapiro Research - Analyst*

Okay. And then, just to follow-up on the FAS/CAS. Most of the other companies imply that the CAS does not move around as much as the FAS does. So is it really, maybe just an overly conservative assumption, to assume that they both move equally?

Barbara Niland - *Huntington Ingalls Industries Inc. - Corporate VP, Business Management & CFO*

It was a conservative assumption. Really, when you think about this, not only is it the expense side, but it's really moves the liability side, and that's really when you want to see the discount rate go up for.

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

Yes, I would point out George, that overly was your word, not ours

George Shapiro - *Shapiro Research - Analyst*

(laughter). Okay, then Mike, when you talked about 9% to 10% range for shipbuilding, and then you talk about the difficulties of Newport over the next year or two. Is it possible that Newport's margin would drop below the 9%, but Ingalls would enough higher, that you're still in the range that you're talking about?

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

Well, I think in the macro, that's certainly one possible future for us. I mean, our targets are to keep both of our business in the 9% to 10% range. The challenge that Newport News has right now is, not only do they have those three carrier deliveries, but they are all cost type work.

And so, that's a little bit -- just the contract types are off-balance for them, as to where they normally are. The normal carrier construction is a price type contract, as opposed to a cost type contract. And so, there is a little bit of imbalance in contract type at Newport News that they are going to be working through, at the same time that they are working through these three contact deliveries. And so, that's a little bit -- in my experience, that's a bit unusual for them, and that's going to put some pressure on them.

We've got a great team there, and they are doing what they need to do, and we've some good targets for them. But in the aggregate, I think it's fair -- you've got a good point. If you step back and look at the entire shipbuilding business in aggregate, we certainly believe that we are going to be in that range for as far as we can see.

George Shapiro - *Shapiro Research - Analyst*

Okay. Thanks very much.

Barbara Niland - *Huntington Ingalls Industries Inc. - Corporate VP, Business Management & CFO*

Thank you.

Operator

(Operator Instructions)

Myles Walton, Deutsche Bank.

Myles Walton - *Deutsche Bank - Analyst*

Thanks. Sorry about the technical issues last time. Mike, you talked about the 18-month delivery for the three carriers. And I wonder how much of a proxy of the headcount reduction we should think about as a proxy for the sales headwind that you are anticipating on the back of those leaving the shipyard? And then secondarily, can you size for us, or maybe just a rough order of magnitude, or a comment on the Ingalls toward the end of the decade, what kind of revenue profile headwinds there may or may not be that authorizers seem to be looking to accelerate ships into to avoid?

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

Right. So certainly, when you are at this point, where we are reducing headcount at Newport News, that's going to have some effect have some volume on Newport News. But as I've pointed out, Newport News -- if you step back and look at this over a 5- or 10-year period as we look at, they have in my view, they have the brightest future of any of the businesses in industry, because the demand for the products that they have out there is higher. It's making headlines.

And so, there is a build up of the demand for the work that Newport News is doing. And it's just we've got to get through this kind of end phase of this last cycle, the new class of ships, the inactivation, and the delay that we saw in the refueling, that we've got to work that turbulence to get to, the beginning of that future. And so, if you go out over five years, I think Newport News is going to be in great shape.

At Ingalls, I think it's little bit different in that things are going really great there right now. We've got four different classes of ships under construction in that shipyard. But if you looked down the side line of each of those classes, you start to see that that follow-on programs are where all the risk is going to be. We're at the end of the LPD program, for instance.

And so, the decision to bridge from the LPD program to the LXR program via LPD-28 is a huge decision for Ingalls, and it does create some stability going forward, assuming the LXR program can be accelerated. And as we've talked about before, the LXR program is going to be, I think tied to what happens with the Ohio replacement program. So these things are all intertwined.

The destroyer program at Ingalls, I think, is in reasonably good shape going forward, in terms of the outlook for destroyers. The large tech amphibs, we are building the seven today, and we will be competing -- we're in a competition for the eight going forward, with the LHA 8 and the TAOX, and so that needs to get settled. But then the question is, what happens after that? And then the NSC, we are building six, the program of record was for eight. There is talk of a ninth one, so that's playing out there. There is a discussion of a icebreaker out there, that is in there.

So Ingalls, it's a little bit harder to pin down where Ingalls is going to be in 5 or 10 years, than it's to pin down Newport News, and a little bit more dynamic environment at Ingalls. And it's -- a lot of their success in the future depends on how well they do the work they're doing today. And we are very, very pleased with where we stand.

Myles Walton - *Deutsche Bank - Analyst*

And one other one, Mike, if I could. The ship building account to be set aside, or potentially set aside for the Boomer and other items outside of the typical shipbuilding budget -- what's in a scenario, what is the right size for that budget to be, kind of on a go-forward basis, as you think about it?

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

Yes, I mean, that's a good question. I am less concerned with the mechanism for the funding. The legislative branch has created a mechanism for the funding. I think that the Department of Defense is thinking about whether that's the right mechanism, or if there is another way to do it, or do we just bring it back into the shipbuilding account.

I think what matters here is that you fund the design, and you fund the early lead time procurement -- you fund that on time. If you -- we have seen -- excuse me -- we have seen over and over and over again what happens when you get yourself in a place where you need to move into production, and the design is not done, or the suppliers are not sorted out. And so, I think what matters right now is that we keep the funding profile for the design and the early procurement, because that's going to set the stage for early success in that program. And that's going to be ramping up over the next few years, and it's a pretty healthy requirement to keep that program on track.

Myles Walton - *Deutsche Bank - Analyst*

Thank you.

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

You bet.

Operator

Thank you. At this time, I would like to turn the call back over to Mike Petters for any closing remarks.

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

Well, I want to thank everyone again for joining us on today's call. And I want to wrap up, by making sure that you know, that you can still sign up to come to our Investor Day, either in person or via webcast next Tuesday, starting at 8:30 Eastern standard Time. Just go to our website, click on the Investor Relations page, follow the Investor Day link, and you can register and be part of our discussion on Tuesday morning. We really appreciate your interest in our Company, and we look forward to seeing you. Thanks.

Operator

Thank you for participating in today's conference. This does conclude the program, and you may now disconnect. Everyone, have a great day.

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