

# FINAL TRANSCRIPT

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**ORB - Q2 2009 Orbital Sciences Corporation Earnings Conference Call**

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*Orbital Sciences Corporation - Chairman & CEO*

**Garrett Pierce**

*Orbital Sciences Corporation - Vice Chairman & CFO*

**J.R. Thompson**

*Orbital Sciences Corporation - Vice Chairman, President, COO*

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**Chris Donaghey**

*SunTrust Robinson - Analyst*

**Howard Rubel**

*Jefferies & Company - Analyst*

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**Gary Liebowitz**

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## PRESENTATION

**Operator**

Good morning, my name is Amy, and I will be your conference operator today. At this time, I would like to welcome everyone to the Second Quarter Financial Results Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. (Operator Instructions) Thank you. Mr. Thompson, you may begin your conference.

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**David Thompson - Orbital Sciences Corporation - Chairman & CEO**

Good morning, everyone. Thank you for joining us for Orbital's Second Quarter 2009 Financial Results Call. I am Dave Thompson and with me on the phone today are J.R. Thompson and Garrett Pierce.

Before we get underway, I would like to ask everyone to take special note of the Safe Harbor paragraph at the end of our earnings release. This paragraph emphasizes the major risks and uncertainties in the forward-looking statements that we will make this morning. Please keep this in mind as we discuss our future financial and operational plans and guidance during today's call.

We will follow our customary outline for the call this morning. I will begin by discussing some highlights from the second quarter and then turn it over to Garrett, who will cover our financial results in greater detail and also update the guidance for the full year. After that, J.R. will recap recent space missions, major system deliveries, and other operational matters from the second quarter. He will also provide a preview of upcoming launches, deliveries, and related operational events over the next three months.

Finally, I will address second quarter new orders and contract backlog as well as our new business outlook for the second half of the year. At that point, we'll open up the call for your questions.



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To set the stage for today's discussion, I will begin by highlighting three areas, which characterize the Company's second quarter. We will cover each of these in more depth later in this morning's discussion.

First, let's look at financial performance. Orbital's financial results in the second quarter were mixed. Revenues decreased 10% to \$270 million with sales growth in launch vehicles being more than offset by declines in satellites and advanced space programs. Operating income was \$12.8 million. This reflected profit margins that were better than expected in satellites, in line with projections for launch vehicles and below plan in advanced programs.

Earnings per share were \$0.15 compared to \$0.17 this time a year ago. Free cash flow was \$16 million, which boosted our cash balance to a record \$340 million as of the end of June.

Finally, as Garrett will discuss, we are reducing our guidance for the full year to account for delays in new commercial satellite orders and the termination of the KEI missile defense program, which took place in the second quarter together with lower margins so that we now foresee in advanced programs this year.

Next -- let's turn to operational highlights. The Company carried our three space missions and delivered seven additional systems for future uses during the second quarter. In our Taurus II launch vehicle and Cygnus cargo spacecraft development programs, we completed the Taurus II final design review and the Cygnus preliminary design review in the quarter. We also began construction of ground processing and launchpad facilities for these systems at Wallops Island, Virginia.

Looking ahead, as J.R. will describe in more detail, we are preparing to conduct two space missions and to deliver nine or 10 other launch vehicles and space systems in the third quarter with an additional eight to 10 mission and four or five deliveries projected for the fourth quarter of this year.

Finally, here is the summary of our new business activity -- Orbital's second quarter new business volume totaled approximately \$210 million, which brought first-half new orders and option exercises to about \$690 million. Scientific and military satellite orders accounted for about two-thirds of the second quarter's bookings while total contract backlog increased by over \$700 million compared to this time last year to around \$4.9 billion as of the end of June, firm backlog dropped by about \$400 million primarily due to the termination of the KEI program, which took place in May.

Looking ahead, we are pursuing over \$700 million of potential new orders and option exercises that should be decided by the end of this year, which I will comment on in a bit more detail later in the call.

Before doing that, though, I would now like to ask Garrett to take you through the financial results from the second quarter and to update our guidance for 2009. Garrett?

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**Garrett Pierce** - *Orbital Sciences Corporation - Vice Chairman & CFO*

Thank you, Dave, good morning. Before commenting on the financial results, I want you to know that during this call we will provide certain non-GAAP financial measures. A reconciliation of these measures to comparable GAAP financial measures can be found in our earnings release or, to the extent not addressed there but discussed in this call, will be available as an appendix to the transcript of this call and will be posted under the "Investor Relations" heading on our website.

Dave summarized the financial results. I will now go into more detail to highlight the more salient items that impacted the second quarter in our full-year guidance. Revenues for the second quarter 2009 were \$270 million compared to \$301 million in the second quarter of 2008, a decrease of 10%, or \$31 million.

Operating income for the second quarter 2009 was \$12.8 million compared to \$26.5 million in the second quarter of 2008. The second quarter of 2009 included \$6.9 million of unrecovered R&D costs. The second quarter 2008 included \$1.7 million of



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unrecovered costs and a \$4 million legal expense recovery. Adjusting for these items, operating income was \$19.7 million for the second quarter 2009 as compared to \$24.2 million for the second quarter 2008.

The first quarter of 2009, or the trailing quarter, operating income, adjusted for unrecovered R&D, was \$17.2 million. Our advanced space programs segment revenues decreased \$18 million, or 22% due to lower activity in the Orion program, partially offset by an increase in national security satellites, or abbreviated, NSS program activity. The advanced space program segment reported operating income of \$1 million for the quarter as compared to \$5.7 million in the second quarter of 2008. This decrease reflects lower revenue in the Orion program and lower margins on certain national security satellite programs due to delays in cost increases.

Our Satellites in Space systems segment revenues were down \$14 million -- were 13% due to lower revenues from GEO satellites. However, operating margins in the satellite segment were 8.2% in the second quarter as compared to 7% in the second quarter of 2008 and also up from 7.1% in the first quarter of 2009, or the trailing quarter.

This margin increase was due to favorable profit adjustments made in the quarter for certain GEO satellite contracts nearing completion.

Revenue decreases in our satellites and advanced space program segments were offset, in part, by a \$2.1 million revenue growth in our launch vehicle segment, primarily driven by missile defense interceptor contracts. However, launch vehicle segment operating income decreased \$9.3 million compared to the second quarter of 2008 because of a \$5.2 million increase and on the recovered research and development costs incurred in the second quarter of 2009 versus \$1.9 million in 2008 for a net increase of \$5.2 million. And recovery of recovery of \$4 million of certain legal costs in the second quarter of 2008. Excluding unrecovered R&D costs, the launch vehicle segment adjusted operating margin was 9.4% for the second quarter. This is comparable to the second quarter 2008 adjusted operating margin of 10%.

Interest and other income in the second quarter 2009 included a \$1.1 million capital gain on the sale of securities acquired a number of years ago that were monetized through an IPO during the quarter. We also took a \$600,000 noncash charge on our auction rate securities and recorded a \$1.2 million noncash interest charge as a result of the change in accounting for our convertible debt.

The effective tax rate in the second quarter of 2009 was 26%, which includes a catch-up adjustment to reflect the change of the effective rate for the year from 32% to 30%. This reduction in the effective rate is the product of lower forecasted pretax income together with slightly higher estimated research and experimentation tax credits for the year.

Free cash flow for the second quarter was \$15.8 million, capital expenditures were \$12.5 million in the quarter. Our cash position remains strong. At the end of the quarter, we had approximately \$340 million in cash.

During the second quarter, Orbital purchased 163,000 shares of its outstanding common stock at a price of \$12.92 for a total of \$2.1 million. During the first half of 2009, we purchased 1.2 million shares at \$14.26 per share, or a total of \$16.7 million. Under the Board of Directors' \$50 million authorization as approved in March of this year as of the second quarter 2009, we have \$45.6 million available for common stock purchases through March 2010.

Since the inception of our buyback program in 2004, we have purchased approximately 12.8 million shares at a total cost of \$207 million at an average price of \$16.23.

We have lowered our guidance for revenues for the year to reflect a reduction in forecasted GEO business primarily due to lower anticipated satellite bookings and the cancellation of the KEI program. These revenue reductions are offset, in part, by an increase in forecasted revenues from the Orion and NSS programs. The net impact of these factors is about \$40 million reduction in forecasted revenues and about \$0.04 reduction in earnings per share for the year.



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Our full-year forecasted operating results are also expected to be impacted by a number of other factors lowering operating margins and EPS. We believe that the startup cost for the CRS program will lower 2009 operating income by \$4 million, or \$0.04 per share. However, we expect that the CRS program will achieve our targeted profit margin levels as we move up the learning curve in future periods.

Cost overruns and delays in certain NSS programs will impact profitability by about \$0.04 per share. Further, revenue mix and other factors are expected to reduce full-year results by about \$0.03 per share. These items listed total \$0.11 per share and equal a 100-basis-point reduction in margins as reflected in our new guidance.

Consequently, forecasted operating income margin has been reduced by 100 basis points to the range of 4.25% to 4.50%, and EPS has been lowered by \$0.15 to a range of \$0.55 to \$0.60 per share.

Relatedly, we are adjusting our free cash flow by \$15 million to a range of \$50 million to \$60 million. As previously mentioned, we have lowered our effective tax rate from 32% to 30% for the year. Finally, due to delays in an anticipated new GEO and NSS business, we expect that revenue and operating income will be higher in the fourth quarter than the third.

Further, the results of the third quarter will be impacted by higher unrecovered Taurus II research and development expenses, which we forecast will reach a peak level in the third quarter.

Now back to Dave.

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**David Thompson** - *Orbital Sciences Corporation - Chairman & CEO*

Okay, thanks, Garrett. I would now like to ask J.R. to update us on the Company's major operational events from the June quarter and to preview what's ahead this quarter and for the remainder of the year. J.R.?

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**J.R. Thompson** - *Orbital Sciences Corporation - Vice Chairman, President, COO*

Thanks, Dave, and good morning. Operational results were solid in the second quarter with the delivery of two GEO communication satellites and seven rockets. An Intelsat GEO communications satellite was delivered early in the quarter for launch later this year. The MEASAT-3a satellite was delivered mid-quarter, and since has been successfully launched, checked out, and turned over to the customer.

Four Navy supersonic sea-skimming targets were delivered for operational use later in the year. The Orbital Orion program launch abort system, jettison motor, and abort motors were delivered to the White Sands Missile Range for the launch abort pad testing now scheduled to be conducted later this year or in early January of next year.

An OBV interceptor was delivered for the upcoming flight test and planned intercept out of the regular missile range plan for late September. Three missile tests were successfully conducted during the quarter and including the Wallops Island launch of the Minotaur I launch vehicle carrying the TacSat III spacecraft to orbit, the Hubble space telescope servicing mission, and the previously mentioned MEASAT-3a GEO communication launch.

2009 continues to shape up as a busy year in launch vehicle interceptor work with the delivery to Boeing of five OBVs with the planned intercept flight test scheduled for late September out of the Vandenberg Air Force Base. The KEI program has been terminated for convenience by the US government with a larger fraction of the affected employees already redeployed to other programs, primarily the development of the work on the Minotaur IV launch vehicle.

We are also preparing to aggressively respond to MDA's soon-to-be-released targets and countermeasures and new acquisition plan due out late this fall.

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With the delivery of the launch abort system jettison and abort motors to the White Sands missile range, our focus is now on the development of the control motor with the first full-scale firing planned for November with delivery of the second unit to White Sands for the pad abort test.

Our satellite manufacturing facility has been busy with the delivery of four GEO communication satellites in the first half. Ten satellites are now currently in some phase of our integration and test space.

Intelsat 16 is now nearing completion and will be delivered a little bit later in the year. We are scheduled to launch and check out another three more GEO communication satellites this year. The recent win of a Thor 6R as a hedge against the Thor 6 launch and perhaps two other wins summarize likely new business opportunities for our satellite business for this year.

The OCO 2 clone -- a clone of the OCO 1 satellite is looking more likely now and should be known a little later in September. Our national security systems satellite business continues to do quite well. Growth here should offset any shortcoming in our commercial sector business.

We are making solid progress in the Taurus II rocket development, and Cygnus space station's rendezvous re-supply program. Substantial federal funding now appears likely and will assure completion of the Wallops Island launch and spacecraft processing complex scheduled for activation next year. A groundbreaking ceremony occurred during the quarter, and launchpad preparation will begin early next month.

We completed the Taurus II ground support system CDR last month. Delivery of the cryogenic first-stage from the Ukraine remains on track for delivery to Wallops Island by May of 2010. Completion of the Stennis facility to calibrate and acceptance test our engines is running about two months behind schedule but will allow testing to begin later this year.

In parallel, engine stress and endurance testing will begin at the Russian manufacturers' facility in Samara, Russia, within the month of September or early October to confirm the integrity of these vintage engines.

Solid rocket motor second stage is progressing on schedule with motor static firing schedule for October. Cygnus spacecraft development and the initial COTS mission planning is well along. We have completed the COTS system level PDR and are focusing on the space station rendezvous operational safety review schedule for next month. All major procurements are now in place, and supplier selections have been made. Launch of the COTS mission remains on schedule for the early part of 2010 to be followed by CRS missions 1 through 8 on approximately six-month centers.

Looking ahead to the third quarter, we expect major system deliveries to include nine rockets, three OBV interceptors, two Navy supersonic sea-skimming targets, a Patriot vehicle launch system, a medium-range target system, the Orion launch abort system control motor delivered to White Sands, and a Minotaur IV for the SBSS, space-based surveillance satellite.

In addition, the Taurus II engine testing position at Stennis will be nearing completion, and a high-fidelity engine simulator will have been delivered. The MT 33 margin and endurance test demonstration results will be available, and we will be within a year of launchpad of forecasting at launch.

And now I'll return the discussion back to Dave.

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**David Thompson** - *Orbital Sciences Corporation - Chairman & CEO*

Okay, thank you, J.R. I will now report on second quarter new business and contract backlog, and I'll also comment on our overall market outlook for the next six months.



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Of our \$210 million and total new business volume in the second quarter, \$165 million was in the form of new orders, and \$45 million was in option exercises under previously awarded contracts. By reporting segment, satellites and space systems led the way this quarter with approximately \$90 million in new business followed by advanced programs with \$65 million and launch systems with \$55 million.

The Company ended the June quarter with firm contract backlog of approximately \$1.56 billion and total backlog of about \$4.90 billion.

The most notable second quarter orders were awards for one new science satellite from NASA and another military space system from a US government customer.

Although we did not receive any major new orders for commercial communication satellites in the quarter, the Company did win an early-start contract for what we hope will be a full go-ahead on a new communication satellite later this year.

We also booked another production order for 14 supersonic sea-skimming target vehicles from the US Navy. In addition, as I think most of you know, the missile defense agency terminated the KEI interceptor program in May. This reduced our second quarter firm backlog by about \$375 million and also cut option backlog by about \$320 million.

Looking ahead to the third and fourth quarters of the year, our current new business pursuits have a potential value of between \$700 million and \$750 million. As we see it now, they would consist of \$300 million to \$325 million in our advanced space programs segment; \$250 million to \$275 million of satellites and space systems wins; and \$150 million to \$175 million of launch vehicle new bookings.

Included in these totals would be three or four space launch vehicles; two or three commercial communication satellites; three science and military spacecraft; and several new target vehicle orders.

Finally, I'd like to just add to a few things that J.R. has already reported on concerning progress in our Taurus II launch vehicle and Cygnus spacecraft development programs. As J.R. indicated, the engineering designs on both of these systems are now substantially complete, and we remain on track for beginning major ground testing of propulsion structures and avionics elements this fall and through the winter.

We also expect to complete the Wallops Island launch infrastructure by about this time next year.

On a cost basis, we are currently about 45% complete on the Taurus II development program, and around 25% complete on the Cygnus development program in support of the COTS demonstration mission. Both the Taurus II and the Cygnus spacecraft remain on schedule for an early 2011 first launch to demonstrate the cargo delivery capabilities to the space station followed, as J.R. indicated, with operational missions at the rate of about once every six months thereafter.

To wrap up, second quarter results reflected both positive and negative elements. Despite the termination of the KEI program and delays in starting work on new commercial satellites, I remain optimistic that Orbital's new business opportunities are strong and that we will re-establish revenue growth as satellite and advanced programs activity ramps back up in the next six months.

In addition, as our Taurus II research and development spending begins to drop later this year from the peak values that we saw in the second and again in the third quarter, overall operating margins should start their return to 2007 and 2008 levels, which we expect to reach over the next couple of years.

As before, the Company also continues to target high single-digit to low double-digit annual revenue growth and, with that, substantial EPS gains beginning next year and extending through 2012 and beyond.



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Thank you for your attention. I think we are now ready to open up the call for questions.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) Chris Donaghey, SunTrust Robinson.

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### Chris Donaghey - SunTrust Robinson - Analyst

Dave, first of all, on the cost overruns in the advanced space program segment -- is this still related to the same fixed price development contract that was impacting you in the first quarter? And, second of all, how comfortable are you with the visibility into what it's going to cost to get through the development phase through the back half of this year? And is it confined to 2009?

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### David Thompson - Orbital Sciences Corporation - Chairman & CEO

Okay, Chris. Yes, there was a small additional impact from the cost increases on the program that had a bigger impact in the first quarter. We are, I think, about 60% or so complete on that now, and although it may produce a minor drag in the second half of the year, we think that will diminish and be behind us by the end of the year. It was not a large factor in the second quarter, and I would expect it to be an even smaller one this quarter and at the final quarter of the year. And, by the end of the year, it should be just about washed through the system. Although we don't actually finish the contract until about this time next year, its overall impact would be small on results after the next quarter or two.

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### Chris Donaghey - SunTrust Robinson - Analyst

Okay and, I guess, then, maybe -- Garrett, can you kind of walk back through the adjustments to guidance for this year and, I guess, where you can provide a little bit more detail -- I think you said \$0.04 for just cost overruns, in general. Did you say \$0.04 for the CRS program itself and then \$0.03 for other items?

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### Garrett Pierce - Orbital Sciences Corporation - Vice Chairman & CFO

Sure, Chris. What I said was, firstly, that we're taking the projected revenue down for the year by about \$40 million, and that would reduce earnings by about \$0.04. And I went on to say these are principally cost items that impact the margins. As we are looking at the CRS program, this is projection -- there are certain startup costs on it that we believe will occur, and that could impact the year by \$4 million, or \$0.04.

Then I went on to say that there are certain NSS programs that we have that the startup has been delayed a bit. We have a team in place that will remain with the program, so once the program turns on, it will be throwing off revenue. So there's a drag on earnings due to that. And I also talked about \$0.04, and I also talked about some revenue mix and other factors that could impact the quarter by about \$0.03.

We have a Glory contract we're working on right now that could impact the second half of the year. So when we add that all up, that's \$0.11 plus the \$0.04 on revenue -- that's the \$0.15 that impacts the bottom line.

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**David Thompson** - *Orbital Sciences Corporation - Chairman & CEO*

Just to add a little bit more to one aspect of that, Chris. In the national security space area, we've had a very good first half of the year from the standpoint of winning new business. However, with the change in administration has come changes in leadership at several of the agencies that we do business with, and some of those new contracts that we were competing for and won have been delayed by a few months in starting up. So instead of getting a particular contract in May, we are just starting now. Instead of starting another contract this month, we are expecting to start in September.

We don't really want to disband our teams that had done the early work that led to our selection of those contracts, so we are swallowing those costs over the summer months to make sure we're ready to ramp up rapidly when we get the full go-ahead. In one case, we received that a few weeks ago; in another case, we're expecting to receive it right after Labor Day. But the effect of all that has been to add a couple million dollars of unanticipated costs that we probably won't recover on those contracts, once they officially start.

**Chris Donaghey** - *SunTrust Robinson - Analyst*

Okay, great. That's very helpful. And then just, real quickly, on Taurus II -- you mentioned that the third quarter is going to be the peak level of expenses. I thought it was going to be the second quarter. Has there been an adjustment there or did the change in the NASA COTS demonstration mission have an impact there? Can you just walk us through what happened on -- ?

**David Thompson** - *Orbital Sciences Corporation - Chairman & CEO*

Sure, Chris. No, your memory is correct. We had expected that the second quarter was going to be the peak. We didn't spend quite as much as we expected in the quarter, and as a result I think something on the order of \$1 million, or maybe somebody can give me a more precise number.

**Unidentified Company Representative**

\$1 million to \$1.5 million.

**David Thompson** - *Orbital Sciences Corporation - Chairman & CEO*

Something on the order of to \$1 million to \$1.5 million moved from the second quarter to the third quarter. The overall outlook for the year and for the program remains unchanged. We still expect to incur on the order of \$25 million or, in EPS terms, \$0.25 of unrecovered R&D this year on the Taurus II development work and as of midyear, I think we were roughly halfway through that. Let's see, I think we were 12 -- if my numbers are correct, I think we incurred about just under \$12.5 million of Taurus II unrecovered R&D in the first half of the year. So we're about halfway through -- the second quarter was light by \$1 million or so, and the third quarter will be a little heavier by about the same amount. The fourth quarter should see a more significant dropoff and next year, as previously indicated, a very substantial dropoff as we round the final corner and head towards the finish line in the development work by the fall of next year.

**Operator**

Howard Rubel, Jefferies & Company.

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**Howard Rubel** - *Jefferies & Company - Analyst*

First, I want to go back to Taurus, Dave. Could you talk about or address how you feel in terms of the schedule? I mean, it has moved a little bit but there hasn't been any major slippage. What are the big risks that you see, going forward, that you need to retire so that we could externally see them and feel comfortable?

**David Thompson** - *Orbital Sciences Corporation - Chairman & CEO*

Good morning, Howard. Yes, the overall schedule has held fairly well. The biggest risk remaining, I think, are the same ones that were identified earlier; namely, the first stage main propulsion system -- both the testing of the engines and the integration of those engines into the first stage airframe.

J.R. mentioned at least in some of -- partially covered this in some of his comments -- we are running a couple of months late in activating the test facility at the NASA Stennis Space Center to begin the engine-level testing that had been set to happen in the early fall. Now it's going to be late fall, early winter. But the -- in the runup to that, we do plan to do some supplementary testing of engines at the original manufacturers' location in Russia to supplement that.

I think we're feeling pretty good right now about things at the engine level. I guess my biggest concern would remain at the first stage airframe to engine integration level. The testing on that is not really going to start until about -- well, a little bit before this time next year, in the early summer of 2010. And so until we get to that point, that risk, I think, would need to be considered not fully resolved.

The rest of the system seems to be progressing quite well. The second stage avionics, structural elements and so on, are all behaving well both in terms of their technical performance and their schedules and cost. And the launch site is also now moving forward with construction, so I think the primary risk concerns the first stage and, more specifically, the propulsion, and we'll have better insight into the engine side of that by the end of the year, but we won't have the full story in terms of engine airframe integration for the better part of one year.

**Howard Rubel** - *Jefferies & Company - Analyst*

That makes -- so in your experience, this is sort of -- you know, there's a couple of bumps in the road, but there's been nothing that's like "Uh-oh."

**David Thompson** - *Orbital Sciences Corporation - Chairman & CEO*

That's correct. Overall, I think we are feeling -- I mean, development programs of this magnitude always have some unknowns involved in them, but I think we're feeling pretty good right now about where things stand with the primary focus being on that hot spot, the first stage propulsion.

**Howard Rubel** - *Jefferies & Company - Analyst*

Two more things, thank you. One on communication satellites -- you talked about delays. Is that kind of economic-driven, or is it some other market issue? And then just related to that, I recall some months back you talked about spending additional funds to grow the capability of your communication satellite offering. Where does that stand? And then related to that, could you also address how you are thinking about return on -- well, I just need to call it earnings growth or return on investment, because we've gone through quite a bit of investment here, and the returns are a little bit out.



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**David Thompson** - *Orbital Sciences Corporation - Chairman & CEO*

Okay, sure. Let me take those in order. First of all, the overall level of demand for new commercial communication satellites has held up better than I thought it would for the first half of the year. Across the industry, and including all sizes of commercial communication satellites, there have been 18 new spacecraft purchased from the beginning of the year through the present time. I think 17 of those were in the first half, and there has been one new order announced so far this month, which puts this year on pace to equal last year, which is a little surprising to me.

However, in our segment of small, 5-kilowatt and smaller satellites, there have only been two orders, so far, which is below -- in terms of percentage or unit count -- is below what we've seen over the last three years. I can't point to any systematic reason for that. I suspect it is just largely a random effect of still relatively small numbers.

For the full year, given that we've already seen 18 orders, we have now increased our outlook for industry-wide new bookings to somewhere in the 21 to 24 satellite range, which is likely to include between four and five small ones. And so we continue to target three new orders this year. It's possible we'll fall a little short of that, but we do have three good opportunities we are pursuing now. Two of those are with existing customers, and one is with -- for us, would be what would be a new customer.

So I think it's mostly timing, but we'll have to see if that conclusion is correct as we move through this quarter and into the fall.

Now, on the second part of your question concerning the work that we've been doing over the past year -- on a medium-class satellite, we did complete our preliminary design review on that satellite back in May, and that's how far we had planned to take it and then wait for customer reactions. Several of the larger satellite operators are now reviewing that. I think, so far, it's gotten favorable response, but our spending on it has ramped down as we await decisions that those customers may make later in the year.

I am still hopeful that we'll book our first order for such a satellite over the next six months, but we'll have to wait and see whether that lines up with the fleet plans of several of the larger operators.

And then as to the final question -- we -- if we look beyond just this year, we do see a series of improvements beginning next year and continuing out through the 2012 and even beyond period of sizable year-over-year improvements in our operating margin driven by the dropoff in R&D on Taurus II and by the rampup of higher-than-average profitability revenue from the CRS program -- and as we get through some of these startup phases from national security satellites as well.

So putting those two together -- revenue growth at -- on the order of 10% a year, and significant year-over-year margin expansion, we are targeting healthy, very healthy, EPS growth after the period we're in now, where the R&D and other startup costs are weighing down short-term results.

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**Howard Rubel** - *Jefferies & Company - Analyst*

I am just going to end here -- I'm sorry about this -- you'd characterized the KEI loss as an annoyance rather than a strategic or operational setback. Is that fair?

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**David Thompson** - *Orbital Sciences Corporation - Chairman & CEO*

Well, we didn't see -- actually, we didn't really see it coming. From our standpoint, what it means over the next couple of years is the loss of on the order of \$50 million or so of revenue in 2010 and 2011. This year, since it was effectively terminated about midyear, our revenue loss attributable to that will be on the order of \$15 million or \$20 million.



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Fortunately, the larger and longer-standing program, the GMD interceptor, continues to look pretty solid. There have been no adverse changes of any real significance there since the last time we talked. We still have, of the 66 GMD interceptors under contract, we still have 26 of those to deliver through 2012 plus maintenance and upgrades and other work going on not only between now and then but also in the years after 2012. And additional orders may be forthcoming, either to maintain a robust inventory for our West Coast sites or potentially for the third site deployment either in Europe or elsewhere.

However, the third site outlook is cloudy, at least in the short term, and I think it's likely to take until next year before that really clears up. So it's a long -- I guess a little bit longwinded response on KEI. It will not have a major financial impact to the Company, but we would rather not have lost it.

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**Operator**

Troy Lahr, Stifel Nicolaus.

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**Troy Lahr - Stifel Nicolaus - Analyst**

-- of costs? I mean, were those not in your guidance?

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**David Thompson - Orbital Sciences Corporation - Chairman & CEO**

Troy, we didn't catch the first part of your question. Could you run that by us again?

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**Troy Lahr - Stifel Nicolaus - Analyst**

Yes. The CRS startup costs -- were those not in your guidance?

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**Garrett Pierce - Orbital Sciences Corporation - Vice Chairman & CFO**

The CRS startup costs that we just spoke about this morning are in our guidance costs, which I enumerated to be about \$4 million, or \$0.04. Those are projections. We're going to do everything we can to improve that, but that's the current projection.

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**David Thompson - Orbital Sciences Corporation - Chairman & CEO**

Yes, they were not in the prior guidance, Troy, and part of this revolves around the change that we made -- I think we had made this prior to our last call with you in April, where we added a pressurized cargo module to the COTS demonstration mission, and we're still hoping that we can offset any incremental cost from doing that, but we're not sure we can, and so we are taking a little more conservative look at it now than we were some months ago.

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**Troy Lahr - Stifel Nicolaus - Analyst**

Okay. And then on KEI, are there any termination fees that are due to you guys?

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**David Thompson - Orbital Sciences Corporation - Chairman & CEO**

Yes, there might be a little bit of upside there, but it's hard to quantify it now, and I don't expect to see it, probably, until next year. I mean, there is some chance it might come in sooner, but I don't think so. We're not a prime contractor on this program,



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and it's a big job to get all the costs rolled up and reviewed. So there's probably something there, but it's likely to be three or four quarters in the future, not right away.

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**Garrett Pierce** - *Orbital Sciences Corporation - Vice Chairman & CFO*

Yes, we don't see it in the horizon of this year. It would be 2010. These things take time to process.

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**Troy Lahr** - *Stifel Nicolaus - Analyst*

Okay, that's helpful. And then, lastly, I think J.R. talked about the MDA target acquisition plan. Is there something on the horizon? Can you kind of give a little more color on that?

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**David Thompson** - *Orbital Sciences Corporation - Chairman & CEO*

Yes, one of the areas within the missile defense budget that's increased quite a bit this year is for targets and testing. And as part of that, the Missile Defense Agency is set to release request for proposals fairly soon that represents what we see as a pretty good opportunity for Orbital. Their plan is to buy something like 45 target vehicles to cover their needs over a seven- or eight-year period beginning next year, 2010, through 2017 or 2018. And these vehicles would fall into five different categories based on their range from short through medium, intermediate and long, and from our preliminary assessment of the opportunity, it looks like we're pretty well-positioned to compete probably for 30 to maybe 35 of the 45 in total.

This competition is expected to get underway this year, but we don't anticipate contracts being awarded until the first quarter or so of next year, but it is one we're gearing up for now and could make a significant difference in the growth prospects for our target business, which has been kind of flat in recent times, assuming we win a good fraction of it beginning in the first half of next year.

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**Troy Lahr** - *Stifel Nicolaus - Analyst*

So it's not a winner-take-all? They'll just kind of divvy it up in pieces?

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**David Thompson** - *Orbital Sciences Corporation - Chairman & CEO*

That's my understanding. I suspect the Missile Defense Agency will have -- ultimately, have two or three suppliers. Maybe not two suppliers for every category but several suppliers, each of whom may be involved in a couple of the different categories based on range and maybe, with the exception of one category, I think our current products are well-aligned with what they need. So we'll report more on that as time goes by, but it looks like a good opportunity that wasn't really on the radar screen six months ago.

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**Troy Lahr** - *Stifel Nicolaus - Analyst*

Is there a preliminary dollar value associated with that 35 to 35 that you're looking at?

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**David Thompson** - *Orbital Sciences Corporation - Chairman & CEO*

Let me pass on that one for now until we look into it a little bit more. But I'll try to give you some better insight on that not later than our next call.



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**Operator**

Gary Liebowitz, Wells Fargo Securities.

**Gary Liebowitz** - Wells Fargo Securities - Analyst

Garrett, can you talk about the jump in the deferred revenue balance at the end of the prior quarter? Were there one or two large orders that came in? Or what caused the change?

**Garrett Pierce** - Orbital Sciences Corporation - Vice Chairman & CFO

What we have in deferred revenue is our GEO satellite payments -- advance payments that we receive. But the principal movers of that would be payments that were received under the COTS and CRS programs, respectively.

**Gary Liebowitz** - Wells Fargo Securities - Analyst

Okay. And just for clarification, was the pushout of the COTS demonstration launch by a few months -- I guess the prior incentive payment schedule totaled \$170 million. Did that change?

**David Thompson** - Orbital Sciences Corporation - Chairman & CEO

No, it did not. As of now, we have achieved -- I can't remember exactly how many milestones there are. I think something like 17 but that may not be right. And we have achieved more than half of them and have received about \$100 million in payments. And I think the only milestone that changed was probably the launch of (inaudible) itself, which moved three months, but that wasn't a particularly large milestone based on its -- you know, the payment value. All the others have stayed about the same, and we're doing a good job at accomplishing those milestones on the original schedule.

**Gary Liebowitz** - Wells Fargo Securities - Analyst

But weren't there also changes in the scope of requirements that suggests that a greater investment will be needed?

**David Thompson** - Orbital Sciences Corporation - Chairman & CEO

Yes, that's true, and I just kind of briefly referred to that earlier, because we did agree to add to our demonstration mission a pressurized cargo carrier in place of what had been an unpressurized carrier. The reason we did that, or the reason NASA wanted us to do that, was when they selected us for the CRS missions, all of those under the initial contract, all eight of the missions, were pressurized cargo missions. And while they could add unpressurized missions later, it seemed to make more sense to demonstrate the pressurized module that we had specific operational uses already lined up for.

That does have some cost impact. I think we will be able to offset at least some of that impact, but one of the reasons we took down the margin guidance in advanced programs for the year is to reflect some of that coming through as unrecovered R&D. We haven't given up on finding a way to offset all of that but, right now, because that's not something that we've confirmed, we are anticipating some R&D investment in that pressurized module.

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**Gary Liebowitz** - Wells Fargo Securities - Analyst

Okay, thanks. And just one last one for you, Dave. Can you update us on how you're thinking strategically on operationally responsive space. Is this something that Orbital can go at alone or are you considering partnering with some of the other primes or just, in general, how you're going to approach this market?

**David Thompson** - Orbital Sciences Corporation - Chairman & CEO

Well, on the launch -- let me break it up into a couple of pieces, Gary. On the launch side, our Minotaur family has emerged as the launcher of choice for virtually all of the demonstrations of tactical satellite capabilities and operational responsive space technology, to date. We booked another Minotaur order in the first part of the year, and may well see some additional orders later this year for Minotaurs from the Air Force that focus on that mission area.

On the spacecraft side, we are active, to some degree, in that business. I think what will probably determine our strategy of going it alone versus teaming up will be a little more clarity in terms of what traditional missions are most amenable to being supplemented through operationally responsive approaches. In other words, after the next year or two goes by and some of these demonstration missions are carried out, I think it will become clearer if, say, intelligence or imaging missions might be better suited than navigation or communication missions.

But, right now, we are pursuing several of those because it's not yet really clear which ones are going to be the ones that really make the operationally responsive approach pay off. Depending on how that comes out, we might team or not, but it's a little too early to say for sure.

**Operator**

Patrick McCarthy, FBR Capital Markets.

**Patrick McCarthy** - FBR Capital Markets - Analyst

The first question is on the national security satellite side. I was wondering if you could just speak to how many firm fixed-priced contracts you might have in backlog today on the national security side? And then if that's the contract structure that the customer is looking for, do you have any thoughts on what type of operating procedures you want to put in place in order to make sure that you don't see the cost overruns?

**David Thompson** - Orbital Sciences Corporation - Chairman & CEO

Good morning, Patrick, yes, good question. Out of -- let me just say on the order of 10 contracts at this point, two of them are fixed price, and the other seven or eight are more traditional cost-reimbursable contracts. One of those -- well, I guess, actually, to some degree, both but particularly one of those fixed-price contracts is the one that gave us some problems with cost overruns earlier in the year.

We have taken a number of steps to bring in several key individuals with a background in fixed-price satellite contracts drawing from our commercial satellite business and elsewhere to supplement the team in the national security space area. And we've gone through quite a bit of training in the techniques that we've used in the commercial satellite business to make sure that we are preparing our cost estimates properly, and that we are managing very closely to those estimates.

So that's what has happened, so far. I am not -- I mean, we're still watching this very closely to make sure we've got it under control, but I am hopeful that the steps we've taken over the last four or five months will lead to more consistent financial results



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as well as the other things that we've done really well for our customers in that area, beginning right away and continuing for all future periods.

**Gary Liebowitz** - Wells Fargo Securities - Analyst

Okay, great. And my second question -- there was a Navy report out, I guess, talking about the effectiveness of the crew abort system. I know NASA disagrees with it, but I was wondering if you guys had any thoughts on the report.

**David Thompson** - Orbital Sciences Corporation - Chairman & CEO

I know the report that you're referring to. I have not yet read it. I've just heard a little bit about it from some of our people. So I don't have a firsthand response. I think one of the points that the report makes is that, in general, it is more difficult to design a launch escape system from a large, solid propelled launch vehicle than from a comparable liquid vehicle. But I think the -- I suspect, although I don't know this -- I suspect the NASA view on this is probably closer to the truth -- that the system, as designed, would operate very effectively even with a large, solid launch vehicle, but I need to spend a little more time looking at it, which I haven't done yet.

I think we'll bring our discussion to a close at this point. We've gone a little bit over the hour. I'd like to thank you all for joining us this morning, and I hope you all have a good day. Thank you.

**Operator**

This completes today's conference call. You may now disconnect.

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