Northrop Grumman (NOC) Q3 2024 Earnings Call Transcript

By Motley Fool Transcribing – Oct 24, 2024 at 1:45PM

NOC earnings call for the period ending September 30, 2024.

Northrop Grumman (NOC 4.24%)

Q3 2024 Earnings Call

Oct 24, 2024, *9:00 a.m. ET*

IMAGE SOURCE: THE MOTLEY FOOL.

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Prepared Remarks:

Operator

Good day, ladies and gentlemen, and welcome to Northrop Grumman's third-quarter 2024 conference call. Today's call is being recorded. My name is Josh, and I will be your operator today. [Operator instructions] I would now like to turn the call over to your host, Mr.

Todd Ernst, vice president, investor relations. Mr. Ernst, please proceed.

Todd Ernst -- *Vice President, Investor Relations*

Thanks, Josh, and good morning, everyone, and welcome to Northrop Grumman's third-quarter 2024 conference call. Before we start, matters discussed on today's call, including guidance and outlooks for 2024 and beyond, reflect the company's judgment based on information available at the time of this call. They constitute forward-looking statements pursuant to Safe Harbor provisions of federal securities laws. Forward-looking statements involve risks and uncertainties, including those noted in today's press release and our SEC filing.

These risks and uncertainties may cause actual company results to differ materially. Today's call will include non-GAAP financial measures that are reconciled to our GAAP results in our earnings release. Third-quarter results reflect the realignment of the SDS division from space systems to defense systems. In addition, we will refer to a presentation that is posted on our Investor Relations website.

On the call today are Kathy Warden, our Chair, CEO, and president, Dave Keffer, our CFO through September 30th, and Ken Crews, our CFO, as of the first of this month. At this time, I'd like to turn the call over to Kathy. Kathy?

Kathy J. Warden -- *Chair, President, and Chief Executive Officer*

Thanks, Todd. Good morning, everyone, and thank you for joining us. We delivered strong operating performance again in the third quarter, building on the momentum we achieved through the first half of the year. Global events continue to highlight the need for advanced capabilities to defend and deter against increasingly complex threats.

This is driving the demand for our differentiated portfolio and is evident in our results. In the third quarter, our book-to-bill was once again very strong, which drove backlog to a new record level. Our backlog is now $85 billion, which is more than two times our annual revenue, supporting our confidence in the future growth of this business. Revenue has increased 6% year to date, and we are on track to achieve our full-year guidance of 5% growth.

The Northrop Grumman team continues to deliver critical capabilities for our customers, remain disciplined in new business pursuits, and drive cost efficiencies in our operations resulting in this strong performance. Segment operating margins significantly increased, both sequentially and year over year, to 11.5% this quarter, our highest margin rate in over two years. Solid sales volume and strong operating performance drove earnings per share of $7 in the quarter, an increase of 13% from last year's Q3 results. Free cash flow of $730 million was in line with our expectations and continues to provide us the considerable flexibility to deploy capital in support of both growing our business and our shareholder return strategy.

Based on our solid year-to-date results and full-year outlook, we are increasing our EPS guidance range by $0.75. We are pleased with this performance because it's a direct result of the intentional steps we've been taking to realize continued growth and enhanced profitability. We continue to implement productivity and efficiency initiatives, including advanced production capabilities, digital engineering tools, and increased automation. We are streamlining processes, reducing rework, and improving our learning curves as we add up scale, resulting in improved program and operating performance.

The impact of these initiatives was, again, evident this quarter at AS, where execution was outstanding. The mature production portion of AS' portfolio comprises more than half of its overall revenue, and it continues to perform very well. The B21 program has also made solid progress in achieving ground and flight testing milestones on the development contract and is continuing to execute the aircraft production contract in line with our estimates. This is our third quarter in a row of 10% or better margins at AS, due largely to our focus on total cost management and productivity.

Space's performance was also excellent in the quarter. As we expected, revenue was down modestly year over year based on the wind down of NGI and a restricted program, but earnings were up substantially. Strong program performance was the key driver as the team executed well, mitigating risks and realizing opportunities, leading to improved EAC trends in recent quarters. Our defense systems business continues to see broad-based demand, with a book-to-bill of 1.6 times in the quarter, building the foundation for future growth.

Margin performance year to date is solid and consistent with our full-year outlook. While the timing of some of our shorter cycle programs affected sales this quarter, looking forward, DS is expected to be one of our fastest growing segments, with margin expansion opportunities as we realize increased international sales. Like at DS, we also see continued strong demand at mission systems. This segment also had a book-to-bill of 1.6 times in the quarter and robust 7% revenue growth.

Mission systems is a leader in technology that's in high demand from our customers as reflected in their top-line results. And as we've seen this business grow, we've seen mix in productivity pressures, including in supply chain deliveries. The team is making good progress with the deliberate actions they've been taking to improve program performance and drive cost efficiencies. And I have confidence that we are on track to achieve higher MS margins in 2025.

As we look forward, we see multiple trends across our portfolio that are supportive of continued margin expansion, including improving macroeconomic conditions, stabilizing supply chains, enhanced workforce productivity, and gradual shifts in our contract mix as a number of our largest programs transition to production, and we build our international portfolio. We also expect to see continued strong demand for the platform, sensors, and systems we provide that allow our customers to deter adversaries and operate in the most demanding threat environment. This demand is reflected in U.S. budgets, where there's strong bipartisan support for national security priorities.

And as a result, we are seeing upward pressure on defense budgets. Over the past several months, the Senate Defense Authorization and Appropriations legislation proposed additional funding above the administration's fiscal year 2025 defense budget request. And while the legislative process is still playing out, it is encouraging to see strong support for both the budget and our program. As we look at markets outside the U.S., we continue to expect our international sales to grow faster than the rest of our business over the next several years.

There is robust international demand for defense capabilities, particularly in Europ where most NATO members are increasing defense spending from 2022 levels. Th demand is reflected in our international book to bill, which was almost two times in the third quarter. While executing on our current programs is an important driver of our profitable growth outlook, we also remain focused on winning new development programs. Our strategy is based on continuing to deliver technical innovations to create competitive advantage for our customers.

A great example of this is our selection by the Missile Defense Agency to develop the Glide Phase Interceptor, or GPI. This technology will address increasingly sophisticated hypersonic missile threats. In addition, this program is a collaboration between the U.S. and Japan, and will further strengthen the alliance with Japan and further ING's partnership with Japanese industry.

Putting all of this together, as we look forward to 2025, we expect solid growth and strong performance to continue based on our record backlog and continued focus on program execution. At a company level, we project sales growth between 3% and

4%. This includes strong growth in three of our four segments. For space, we expect a mid-single-digit decline due to the wind down on programs I referred to earlier.

We continue to expect the company's segment operating margin to improve in 2025, driven by favorable macro trends, program performance, and cost discipline. Our free cash flow outlook is consistent with our prior long-term forecast, with 2025 increasing greater than 20% year over year. Investing in our growing business remains a priority. We are coming through a period of peak capex, and anticipate a reduced spending level in 2025, but still at a level above historical norms.

And given our company's strong free cash flow outlook, we plan to continue our shareholder-friendly capital deployment strategy, returning approximately 100% of free cash flow to shareholders next year. The dynamic global environment calls for our industry to offer our customers the technology innovations they need to compete. Northrop Grumman continues to invest in the capabilities and capacity needed to deliver that competitive edge for them. We are also intensely focused the talent in digital infrastructure that enables our performance and competitive differentiation.

Our team is delivering today while also building for our future. Financially, this is translating into solid results now, a plan to rapidly expand cash flows over the next several years and a business that is well-positioned for profitable growth for the foreseeable future. Before turning things over, I'd like to welcome Ken Crews, who became our CFO on October 1st. Ken will talk through our forward outlook in just a moment.

But first, I'll turn the call over to Dave for a discussion of our Q3 results. And as I do so, recognizing this will be his last call, I'd like to thank Dave for his leadership and outstanding service to our company. Dave, over to you.

David F. Keffer -- *Corporate Vice President and Chief Financial Officer*

Thanks, Kathy. It's been an incredibly rewarding five years in this role, and I've enjoyed the opportunity to work with you, Ken, and the whole Northrop Grumman team. I'm confident you'll continue to do great things going forward. Now looking at the Q3 results, we continue to experience enduring demand for our capabilities in support of our U.S.

and international customers. As Kathy mentioned, backlog hit a new record of $85 billion, driven by another quarter of strong bookings. Our international awards were particularly strong in Q3 at $2.7 billion, increasing our international backlog to almost $8 billion, the highest level in several years. Key awards included additional E2D aircraft for Japan, ammunition and urgent need capabilities at DS, and radar programs at MS.

We continue to have a wide range of opportunities in our global pipeline that we're optimistic we can convert into bookings and revenue over the coming years. Turning to sales on Slide 4 in our earnings deck, strong momentum from the first half of the year continued in Q3 throughout most of our portfolio. Sales increased by 2% in the quarter and are up 6% year to date. Q3 sales were slightly below our expectation to a few delivery timing shifts to Q4, primarily in DS, but those do not impact the fu year outlook.

Starting with aeronautics, Q3 sales were $2.9 billion, up by 4% compared to the prior year. The increase was driven by higher volume on F-35, E2, and Triton, partially offset by slightly lower sales on restricted programs. At defense systems, third-quarter sales increased by 2%. Higher sales on Sentinel and from our weapons portfolio drove the increase.

As I noted, sales would have been even stronger if not for a shift into Q4 of roughly $150 million of international ammunition sales that are in our backlog. And on Sentinel, we continue to partner with the Air Force on the restructure of the program, which resulted in adjustments to the timing of certain activities as we refine the latest program schedule. Mission system sales were particularly strong in Q3, up 7% compared to the prior year. MS saw an increase in sales throughout much of its portfolio, led by higher volume on microelectronics and advanced technology programs.

And space sales were lower by 3%, consistent with our expectations, due to a headwind of $224 million in the period from the wind down of our work on the restricted space and NGI programs. The remaining space portfolio grew at mid-single digits, driven by higher sales on SDA satellite programs and other restricted work. Moving to the bottom line, Q3 segment operating income expanded to 11.5%. This performance was enabled by our continued focus on cost efficiencies, risk retirements, and outstanding program performance.

AS operating income grew by 5%, generating an excellent operating margin rate of 10.4% in Q3. DS generated solid performance in the period, with operating income modestly lower than the prior period. Its Q3 operating margin rate included fewer net EAC adjustments and a change in contract mix. Mission systems operating income increased 1%, and its margin rate improved from the first half of the year to 13.8%.

And space delivered a great quarter, with operating income up 14% and an OM ra of 12%. We continue to see improvements in space's program performance based on deliberate actions we've taken, and this was reflected in the level of net favorak earnings adjustments in the period. Turning to Slide 6. Earnings per share in Q3 increased by 13%, driven by the solid segment performance I described as well as from higher net pension income.

A lower federal tax rate and strong performance in our marketable securities portfolio also provided an uplift. Our Q3 tax rate benefited from a net reduction in certain reserves in the period. Keep in mind, for EPS comparison purposes than in the third quarter of last year, we recognized a gain of $0.44 per share associated with the sale of a minority investment. Lastly, I'll take a moment to discuss our cash performance.

Third quarter free cash flow was $730 million, in line with our expectations. Year to date, we remain ahead of our free cash flow position compared to this time last year. And we expect a strong quarter of cash generation in Q4, consistent with our historical pattern. And with that, I'll hand it off to you, Ken.

Kenneth Crews -- *Corporate Vice President and Chief Financial Officer*

Thanks, Dave, and good morning, everyone. I'll spend a few moments on the forward outlook, beginning with our latest segment guidance on Slide 7 in our earnings deck. Aeronautics continues to perform at a high level. And as a result, we are increasing both its margin and sales rate guidance.

We now expect sales of roughly $12 billion, reflecting a year-over-year increase of 11%. With another quarter of strong operating performance, we are increasing its operating margin rate guidance to approximately 10%. This increase reflects our confidence in this business to generate healthy margins even as B-21 scales. At DS, we are modestly lowering our sales guidance to the high $8 billion range, reflecting a mid-single-digit year-over-year growth rate.

This update reflects our latest expectations for lower Sentinel volume this year, driven by timing connected with the program's restructure. And we are increasing our margin rate guidance at Space to the mid-to-high 10% range, while updating ou expectations for margin rate at MS to high 13%. Moving to company-level guidanc We are reaffirming our full-year sales guidance.

At the midpoint of the range, this represents a sequential increase in sales to roughly $10.9 billion in quarter four, similar to the ramp we experienced during the fourth quarter of 2023. Fourth quarter sales will be driven by higher volume on the LRIP phase of B-21 international ammo deliveries at DS and multiple production programs at MS. Based on our successful execution of cost savings initiatives and our strong program performance, we are increasing the lower end of our segment operating income range. Q4 margins at MS and DS are expected to improve sequentially due to production mix and deliveries, while AS and Space margins are expected to be lower sequentially due to mix and lower expected net earnings adjustments.

Altogether, our latest guidance continues to reflect a full-year segment OM rate of 11% at the midpoint. We are reaffirming our guidance range for free cash flow that projects greater than 15% growth at the midpoint. We remain confident in our ability to generate strong and predictable cash flows. Year to date, we've returned $3 billion of cash to shareholders via dividends and share repurchases, and we continue to expect $2.5 billion in repurchases for the full year.

Lastly, we are again increasing our earnings per share expectations, now to a range of $25.65 to $26.05, up by $0.75. This updated range reflects our confidence in continued strong segment performance, lower corporate unallocated costs, lower interest expense and a more favorable tax rate. Next, I wanted to take a moment to talk about pension income. Our pension plans remain in great shape with a funded status over 100% and minimal cash contributions projected over the next several years.

Our funded status drives affordability for our customers and help support strong capital returns to our shareholders. As we've done the last few years, we provided a net pension income sensitivity table for the upcoming year in our earnings deck. Through September 30th, asset returns have been in the low 7% range and disco rates were down modestly. So as we sit here today, there is no change to our 2025 net pension income expectations that we shared in January.

As we look forward to 2025, we remain confident in our business strategy. As Kathy outlined, and as shown on Slide 10, we expect another year of solid growth, continued margin expansion and a lower level of capital expenditures. This combination, along with lower R&D cash taxes and higher CAS recoveries, produces a recipe to rapidly grow our cash flows. At the midpoint, we expect free cash flow growth of over 20% next year.

And with our capital deployment strategy of investing in our business for profitable growth and returning cash to shareholders, free cash flow per share is growing even faster. Also, our 2025 outlook assumes that macro conditions will remain stable and the continuing resolution will have a similar duration to those of recent years. In closing, I believe our strategy will continue to create value for our customers and shareholders, and I'm confident about the opportunities we have ahead. I look forward to engaging further with the investment community over the coming quarters.

I also wanted to take a moment to thank Dave for his leadership and contributions to our company and for support during this transition. With that, let's open the call for your questions.

Questions & Answers:

Operator

Thank you. [Operator instructions] Our first question comes from Robert Stallard with Vertical Research. You may proceed.

Robert Stallard -- *Analyst*

Hi. Thanks so much. Good morning.

Kathy J. Warden -- *Chair, President, and Chief Executive Officer*

Good morning.

Robert Stallard -- *Analyst*

And best of luck, Dave, with your next ventures. A couple of contract or program questions for you, Kathy. First of all, on Sentinel, it looks like the timetable here is moving around a bit. But I was wondering if there was any financial or practical implications as a result of this schedule change? And then secondly, on the program we won in the quarter, GPI, I was wondering -- I mean, it might be classified, I was wondering if you could give us a bit more detail of the contract structure for this program and how the revenues are likely to progress from here? Thank you.

Kathy J. Warden -- *Chair, President, and Chief Executive Officer*

Great. Thanks, Rob. Let me start with Sentinel. As we noted in the call, both this quarter and last, we had incorporated into our outlook for the program the changes that will result from the Nunn-McCurdy review and the restructure process that the Air Force is going through.

That restructure process has started. It has not concluded. We expect it to continue well into next year. And yet we have looked at what we believe is most likely to happen as we do on any of our programs and incorporated that into our estimates.

And so that is the smoothing of sales that you heard us talk about in the resulted from our view of what the ramp will look like as we move into 2025. And we do still expect the program to grow year over year from '24 into '25, just as it did '24 over '23. So a similar profile just moved out a bit over a longer period of time. On GPI, there, we're very pleased to be supporting the missile defense agency in this area to build an interceptor that will defeat hypersonic missile threats.

And you know this is a very important area for national security to be able to defer against these threats as they evolve. We are starting with a piece of work that will continue what we have been doing around risk reduction and design and move to a more mature design in this next phase, getting eventually to a preliminary design review. And then after that, we will move to the next phase of the program. So it is an incremental funding approach, but this down select was important because it signifies that missile defense agency, like their design, and wants to continue in the development process with us.

Robert Stallard -- *Analyst*

That's great. Thank you, Kathy.

Operator

Thank you. Our next question comes from Ronald Epstein with Bank of America. You may proceed.

Ronald Epstein -- *Analyst*

Yeah. Thanks. Good morning, everyone. Kathy, broadly, given the demand you're seeing across the businesses and the growth that you're going to have, what are you seeing in the supply chain? Are there tight points right now? Are there places that you're worried about? Going to be heard broadly from companies across the sector that there are still large supply chain issues.

How are you managing it? And what areas are you worried about and working on?

Kathy J. Warden -- *Chair, President, and Chief Executive Officer*

Yeah, Ron. We still see supply chain challenges mostly with capacity and productivity. And let me unpack that a bit. They aren't concentrated in any one area of the business.

They're broad-based and they tend now to be more supplier dependent. And so we are working with individual suppliers to help them address their particular challenges. It stands from microelectronics to our solid rocket motor business supply chain as they try to ramp to the increased capacity that we are all asking of them. It includes even some of our Space and Aerostructure partners in space and AS, respectively.

And so each of our teams across the segments have their top list of suppliers that they're working with. We do extensive monitoring of our supply chain so that we can hopefully see these issues coming. And then as soon as we do engage with the supplier to provide support, I don't expect that we will see all of these issues mitigated this year. It's improving and in many places, stabilizing, but we are carrying risk and certainly some plans into 2025 to continue to monitor and work with our suppliers.

Ronald Epstein -- *Analyst*

Does it make sense to vertically integrate anywhere just in the supply chain so you can control some of it?

Kathy J. Warden -- *Chair, President, and Chief Executive Officer*

We have not generally taken a strategy of vertically integrating unless we feel that there is no path forward to support the supplier in remaining viable. We obviously, from time to time, move away from a supplier that is not performing to another supplier that we first try to remediate and where we have, very few, or even some places sole source suppliers our first instinct is not to enforce that. It is to support them. But there are times when ultimately, we do find ourselves needing to bring capability in-house to ensure we perform on behalf of our customer commitment.

Ronald Epstein -- *Analyst*

Thank you.

Operator

Thank you. Our next question comes from Sheila Kahyaoglu with Jefferies. You may proceed.

Sheila Kahyaoglu -- *Analyst*

Good morning, Kathy, and everyone. Thank you so much. Maybe if we could talk about the multiyear growth cadence, just looking at the backlog pretty solid and a competitor talked about supply chain and potentially being able to execute to close the gaps. Assuming the headwinds in Space go away and just thinking about flagship programs, what type of growth should we be thinking about and targeting for Northrop over the multiyear time horizon?

Kathy J. Warden -- *Chair, President, and Chief Executive Officer*

Well, we've been growing at 5% compound annual growth since 2019. And each year, we come into the year with opportunities and risks that we work to mitigate, and I'm very proud of the team for having been able to keep and maintain that very solid growth rate for the last five years. As we look forward, we've guided at 3% to 4%, as you know, and that too has both risks and opportunities. We think it's a very balanced approach.

If we were to see some of these supply chain challenges ease, we could see upward pressure on that growth rate if we are competitively successful on opportunities in our pipeline, we could see upward pressure on that growth rate. And if we are able to continue to capture international business at the rate we did in the second -- in the third quarter at two times our sales that certainly will provide some upward pressure on that growth rate. So we are working hard to materialize those opportunities. There are clearly risks as well.

Really, the downside is the flip side of each of those things that I just outlined. But we believe that 3% to 4% next year is a realistic starting point as we enter the year with what we know today. We don't guide beyond that, as you know. But I have sa that I believe this business can continue to grow in that mid-single-digit range.

And so that is the plan that we've laid out for ourselves. And based on what we sec today, we think that's achievable.

Sheila Kahyaoglu -- *Analyst*

Thank you.

Operator

Thank you. Our next question comes from David Strauss with Barclays. You may proceed.

David E. Strauss -- *Analyst*

Good morning, and welcome Ken.

Kenneth Crews -- *Corporate Vice President and Chief Financial Officer*

Thank you. Good morning.

David E. Strauss -- *Analyst*

Kathy, I wanted to see if you could just broadly touch on B-21 and the progress there relative to the charge that you've taken, kind of where you are in sign-up additional LRIP lots, pricing on those, where you are with kind of locking in your suppliers. Yeah, just kind of wherever you want to take it in terms of an update on B-21 and then margin progression at AS. Thanks.

Kathy J. Warden -- *Chair, President, and Chief Executive Officer*

So let me start with B-21 and then I will tie it to the broader AS margin picture because that's important in that. While B-21 is a key program in our company, it is not the majority of AS sales and so the rest of the picture is important in drawing out the view on margin performance for the business, which, as I said, was just outstanding again this quarter. With B-21, we are on track for meeting the milestones associated with an award of LRIP 2. And so we are expecting that to happen in the fourth quarter.

We have talked to you about being awarded approximately annually. And so this is the time of year where happens, and we expect to get that on contract. We have no change to pricing. As you know, those were priced.

And we have no change to our estimate complete based on our third-quarter review. So we are continuing to perform, as I said a few moments ago in alignment with the plan that we have laid out for the B-21. I'm very proud of that team. It's quite a remarkable accomplishment to what they are doing, both on development and production.

As we look at the broader AS through activities they've taken to manage costs and drive productivity, some really innovative work they're doing in workforce training to get new employees onto the factory floor, more productive on day one and down the learning curve quicker. We have been able to really improve our performance on the more mature production programs as well, which has provided even further lift to AS and contributed to the very strong margin rates that we are seeing on that mature production portfolio. We had talked a year ago about that being the vision, and I'm pleased to say that the team has executed it very well.

David E. Strauss -- *Analyst*

Thank you.

Operator

Thank you. Our next question comes from Jason Gursky with Citi. You may proceed.

Jason Gursky -- *Analyst*

Hey. Good morning, everyone. Thanks for taking the call. Question, Kathy, just a quick one for you on the trends going on there in Europe and the pipeline and the bookings that you've been seeing there given the demand.

I'm just curious the contract types that you'll be operating with there, generally speaking, FMS versus direct commercial? And kind of what does that portend for margins across the business is going forward as that mix shifts maybe a little bit more to some international work?

Kathy J. Warden -- *Chair, President, and Chief Executive Officer*

It's a combination of contract types that we see across our international sales portfolio for our ammunition and weapons products. We typically see those as direct commercial sales. And for our more complex weapon systems, anything that would entail integration, for instance, [Inaudible] Triton, we would see those as FMS sales. In both cases, we tend to see those as accretive to overall both segment and company margin rate.

As a result of us being further down the learning curve when we price those because we're building off of mature product lines. And so we expect that trend to continue as we look at the pipeline into next year because some of the weapon system sales are larger. We do see that as a bigger contributor to the growth. But DCS is also an important part of the international pipeline, and we see both growing into next year.

Jason Gursky -- *Analyst*

OK. Great. And then just a quick follow-up, just sticking with contract types domestically, are you seeing interesting comments or observations that you can make about the current contracting environment in the -- any shifts in DoD strategy on how they're going to ask you all to get yourselves on contract going forward?

Kathy J. Warden -- *Chair, President, and Chief Executive Officer*

I haven't seen any significant shift but more dialogue for sure, in terms of what contract type is appropriate for the work that is being conducted. And as a result, we have seen on particular opportunities, a shift from one type to another based on industry engagement. So I think that's healthy. It's helping the government to really understand what motivates industry and what's necessary in terms of the business conditions for us to be able to invest in the way that supports the government ability to get products in a timely fashion.

Because at the end of the day, cost is one element, but schedule is another, and we want to make sure that we can deliver not only what, but when and at the price that is agreed to. So getting the contract type right is an important ingredient to make that all work.

Operator

Thank you. Our next question comes from Scott Deuschle with Deutsche Bank. You may proceed.

Scott Deuschle -- *Analyst*

Hey. Good morning.

Kathy J. Warden -- *Chair, President, and Chief Executive Officer*

Good morning.

Scott Deuschle -- *Analyst*

Ken, was the F-35 program a driver of positive EACs at Aeronautics again this quarter? And then would there be additional opportunity to expand margins on center fuselage over the coming years as you move to newer lots that have some better pricing on them?

Kenneth Crews -- *Corporate Vice President and Chief Financial Officer*

So we're -- thanks for the question, Scott. We're absolutely pleased with AS' performance in the quarter and what drove the overall positive in terms of net earnings adjustments. It really was a portfolio approach. And so it wasn't one program alone.

It was mature production programs from across that portfolio. And we expect that to be the case, and it's really showing the benefits of the deliberate actions that we're taking to drive costs out of the business, to create efficiencies and it's paying off. As we look forward, our team is focused on leveraging the investments we made in our factories to drive efficiencies. And so I do anticipate opportunities across our mature production programs moving forward, leading to improved booking rates.

However, knowing in 2025, we do have a mix shift, particularly related to the growth on the restricted programs, which will put pressure relative to the overall booking rates you saw in AS this year.

Scott Deuschle -- *Analyst*

OK. And then, Ken, maybe just what segments do you view as having the greatest opportunity to expand margins next year? And then maybe you could walk through some of the drivers there that would underpin that?

Kenneth Crews -- *Corporate Vice President and Chief Financial Officer*

Sure. So when we think about next year is we see opportunities to expand margin across three of the four segments for my previous comments on AS. I would say, given the comments that Kathy made before, the mix of international, the focus on weapon systems, I believe DS has -- is one of the major drivers of that margin expansion. Also, too, is with MS, it's important to realize that MS creates an immense amount of value for our company and our shareholders.

They're booking close to 14%. We've seen some headwinds that as we've communicated are temporal in nature. And so as we move forward, do expect MS to continue to see accretive margins. And then long term, as we shift back more toward FFP that margin expansion will continue to get back to the historical norms that we've seen.

And then in space, I think this quarter is an absolute great reflection of space and the activities that they are taking to focus on performance, drive efficiencies into the business. And so we see opportunities there to expand margins as well. So it's going to be a portfolio approach across those three segments and DS should be the primary driver.

Operator

Thank you. Our next question comes from Gautam Khanna with TD Cowen. You may proceed.

Gautam Khanna -- *Analyst*

Yeah. Congrats, Dave and Ken.

David F. Keffer -- *Corporate Vice President and Chief Financial Officer*

Thank you.

Kenneth Crews -- *Corporate Vice President and Chief Financial Officer*

Thanks.

Gautam Khanna -- *Analyst*

I'm curious on two things. One, just big picture, we got an election coming up. Do you see any dramatic differences between either candidate or administration on your programs and defense broadly? And then I have a follow-up.

Kathy J. Warden -- *Chair, President, and Chief Executive Officer*

Thanks, Gautam. And welcome. I do not see a significant difference. What we have seen over time is that the defense budget more reflects the threat environment than any particular administration change.

And so we fully expect that again this time. The National Defense strategy has remained consistent over the past several years and the last couple of administrations. And we believe that's because it is responsive to the emerging threats around the globe and focused on both deterring and defending. And in tha regard, it's well aligned to the program portfolio that Northrop Grumman has with significant portion of our work supporting the U.S.

in both builds and modernization of the nuclear triad, but also a portfolio that very much supports the U.S. and our allies in being able to defend in conflict when called upon. So we expect those to continue to be the driving features of a national defense strategy, and therefore, what the budgets will support and reflect.

Gautam Khanna -- *Analyst*

Thank you. And just a quick follow-up on space beyond 2025. I mean what do you think kind of the longer-term trajectory of that revenue will be?

Kathy J. Warden -- *Chair, President, and Chief Executive Officer*

What we've said about Space beyond 2025 is that we do expect it to return to growth. And we also have said that it's growing mid-single digits without the headwinds of the two programs that are winding down. So it gives you a good sense of what we think that run rate might look like coming out of 2025.

Operator

Thank you. Our next question comes from Doug Harned with Bernstein. You may proceed.

Douglas Harned -- *Analyst*

Hi. Good morning. Thank you. Kathy, I wanted to follow up on the Space question because it's been complicated with the movement of Sentinel and NGI and the classified program.

When you look forward from here, I guess, first of all, is it possible to compare apples-to-apples on what's changed in the space backlog over the past year, if we take out those other programs? And then can you highlight kind of what some of t more important programs -- or program areas will be in getting the growth rate you're talking about?

Kathy J. Warden -- *Chair, President, and Chief Executive Officer*

Sure. When you look at the move of the SDS portfolio from space to defense, it is largely the sentinel program. And so the backlog shifts that we made there gives you a sense of what that profile is Sentinel. And you also can take a look at what's remaining and see that there is a very healthy sized backlog to support the space business.

And while it's made up of a number of programs, many of which are restricted, it is broad-based in its nature. It is supporting ground, satellite builds, it is supporting intelligence missions as well as the Department of Defense and a significant portion of it is NASA and related civilian missions. And so can say is the backlog is well diversified. It is large, and it is in many cases, early stage programs that still have a lot of runway in front of them in terms of either future awards or production volume associated with development program.

Douglas Harned -- *Analyst*

And then just if I can, one follow-up on Defense Systems. Can you give a picture at all of what your expectation is for the percentage you'll get from international over the next couple of years since it is clearly expanding?

Kathy J. Warden -- *Chair, President, and Chief Executive Officer*

Doug, I'd prefer to wait until we guide in 2025 because it is rapidly expanding. And as you know, at this time of year, we're still in our process of laying out the details associated with our long-range plan. And I know you're not just asking for what does that look like in a flip-year flip in 2025. But what does that trajectory look like over time.

And I'll be able to give some more color on that in the January call and we'd be happy to do so since it is an important part of our growth strategy, not just in Defense Systems, but we believe it's material to the company overall. In two other segments, both Aeronautics and Mission Systems have significant international growth opportunities as well.

Operator

Thank you. Our next question comes from Myles Walton with Wolf Research. You may proceed. One moment for our next question.

Our next question comes from Ken Herbert with RBC Capital Markets.

Kenneth Herbert -- *Analyst*

Yeah. Hi. Good morning. Kathy, I wanted to ask you a question about autonomy.

You've got a number of legacy programs here as we go to AUSA and look across the industry funding for autonomy and related technologies just seems to be incredibly strong. How would you characterize your portfolio in autonomy today? Where are you investing? And maybe what do you see as a couple of the big opportunities for you over the next few years?

Kathy J. Warden -- *Chair, President, and Chief Executive Officer*

Yeah. We certainly have been a leader in autonomy and continue to be and across multiple domains and weapon system types. So when you think about our history, it's largely been associated with aircraft. And we clearly are a leader there in truly autonomous, not remotely piloted, but truly autonomous vehicles, having several in operations today and continue to invest in that area for the future of uncrewed aircraft.

When you think about satellites, the command and control of a satellite, it is an ultimate autonomous vehicle. And more and more, the opportunity set in space is around maneuverability and command and control. So we're investing there. And then finally, when you think about weapon systems, they are less expensive, uncrewed vehicles in many cases, and that's not just in the weapon itself, but as we think about the role that they play in defense.

So we are investing in autonomy companywide and really drawing threads across those investments and not thinking so much about the platform that the technology self, which in this case, it's more in the software and integration. And one of the differentiation of our company is that we are not just hardware, we're software and integration, and we've demonstrated that through a number of leading-edge programs that allow us to get the benefit of both worlds coming together at scale and in operation.

Kenneth Herbert -- *Analyst*

That's helpful. And as the software continues to be a driver here, do you think there's risk that on the customer side, sort of adoption or risk appetite could potentially hold back some of the opportunities here? Or how do you think the customer is able to keep up with what you're able to do on the technology side?

Kathy J. Warden -- *Chair, President, and Chief Executive Officer*

I think there's an appetite for the capability that is strong, getting through a certification program, particularly when you think about airworthiness with an autonomous vehicle is not easy, and we've done it, not many companies have, and we have, but it is a rigorous process for good reasons. And it is one that should remain rigorous, and that's really where you need to be assured that your software is sufficiently protected and tested to be able to operate and under conditions where you may have denied communications and jamming and other impacts to what would be rudimentary ways of supporting autonomy or remote piloting. So I'm going into a little bit of detail to just share, it is not an easy task. So the demand certainly is there.

The ability to respond to that demand, I think, will be the pacing item for some companies.

Operator

Thank you. Our next question comes from Myles Walton with Wolfe Research. You may proceed.

Myles Walton -- *Analyst*

Thanks. Good morning. Dave, it sounds like 2024 free cash flow is going to be comfortably at the high end of the range based on your comments. Is that right? And then maybe Ken, on the 2025 outlook for free cash flow, the guidance or the increase is about $600 million.

But that looks like it's just covered with pension, capex, and taxes. So is there a working capital or maybe burn off of B-21 that's offsetting earnings?

Kenneth Crews -- *Corporate Vice President and Chief Financial Officer*

I'll be happy to start, Myles, on 2024 and then hand it to Ken for a discussion of periods beyond. We didn't mean to indicate a direction toward either end of the free cash flow range for this year. As we noted, we've had a strong third quarter and year-to-date performance for free cash flow. I think if you look at prior year trends, you'd see a similar trend line through prior years of the quarterly progression such that Q4 is expected this year as it has been in the past, to be a strong free cash flow quarter.

But we're not meaning to indicate a direction toward either end of the free cash flow range. We're pleased to continue to maintain that really strong range that reflects a strong growth year over year in 2024. So, Ken, over to you for any follow-up discussion on '25.

Sure. So from a working capital perspective, as we've communicated in the past, we expect that to be relatively flat. You'll see it elevated levels right now, and that's just timing as we get through quarter four with the sales profile, it will level to our historical norms. We expect that in 2025, and when we think about what is driving the cash flow expansion in 2025, I would put it in two primary drivers.

The first is operating performance. So as we expand margins and we convert those margins to cash. The other major driver is the reductions in investment from our historical peaks. There are some minor benefits regarding R&D cash taxes as well as cash pension recoveries, but it's really going to be driven by operations and investment levels.

Myles Walton -- *Analyst*

All right. Thank you.

Operator

Thank you. Our next question comes from Seth Seifman with J.P. Morgan. You may proceed.

Seth Seifman -- *Analyst*

Thanks very much. And good morning and congratulations to Dave and Ken. Kathy, I wonder if you could talk a little bit about within Defense Systems and the missiles and munitions, we saw some investments, some additional investment in solid rocket and mortars. And I think there's a sense that there's a lot of capacity coming into the solid rocket and mortar area.

We saw kind of a surge in demand for missiles and munitions, but kind of how enduring is the demand level there? And so I wonder if you could talk a little bit about how you see that given the investments that you're making?

Kathy J. Warden -- *Chair, President, and Chief Executive Officer*

Yeah. We do see that not only the U.S. but multiple allies are likely to need to restock pile munitions. They have donated to Ukraine.

And as a result, we believe that this higher demand signal is enduring for multiple years. We have invested to laying capacity, as you know, and increased capacity more than doubled at the point in moving toward a tripling of capacity with some U.S. government-supported funding. And as we do that, we are working through ou supply chain to ensure it's not just our capacity, but it's theirs as well to support the entire build process.

As others are coming into the marketplace, I think there will come a time when we need to look at how much capacity is enough. We are certainly not at that place in our company at this point in time, the investments that we are making, we are committed to making. And we believe there will be plenty of demand for that capacity. But we'll continue to monitor it as we do any area where we're facilitating to ensure that we don't get out ahead of the demand signal.

Seth Seifman -- *Analyst*

Great. Thanks very much.

Operator

Thank you. Our next question comes from Matt Akers with Wells Fargo. You may proceed.

Matt Akers -- *Analyst*

Hey. Good morning. And Dave good luck. Nice working with you.

Can you talk about kind of capex trends longer term? I think, Kathy, you kind of mentioned in the opening remarks, 25 lower, but still sort of elevated versus historical levels. Is there room for that sort of move down either in absolute terms further out or as a percentage of sales and sort of what's driving that investment right now?

Kathy J. Warden -- *Chair, President, and Chief Executive Officer*

Yeah. I'll take that. We certainly want to ensure we're able to continue to invest in our growing business as well as return cash to shareholders. And it is true for the last several years, we have been investing more heavily in the business because the opportunities were there, and these were good opportunities that would create lon term profitable growth for the company.

As we look over the horizon, we still see opportunities to grow the business, but not as capital intensive as what we have experienced and many of the growth opportunities that we have ahead of us this decade, we have now invested in to support the program and its move to production. So we naturally are seeing less pressure for capex in the out years of our plan. And we are going to be responsive to that by lowering our capex expenditure. I believe it will still be at a historical norm level, not below that, but just not as elevated as it has been in the past several years.

And we've been specific about what that looks like in 2025. We've also said that it will come down further in 2026, but we haven't put more numbers to it beyond 2025.

Matt Akers -- *Analyst*

Got it. Thank you.

Kenneth Crews -- *Corporate Vice President and Chief Financial Officer*

We have time for one more question.

Operator

Our last question comes from Scott Mikus with Melius Research. You may proceed.

Scott Mikus -- *Melius Research -- Analyst*

Good morning. Kathy, I wanted to ask, the Air Force seems very pleased with Northrop's execution on B-201. The program of record calls for 100 production units, but Air Force has publicly stated that its desired inventory is for 150 B-21's. With the Air Force reevaluating at least the men part of NGAD.

Could that free up to get your funding for the Air Force to get to that desired B-21 inventory of 150 units?

Kathy J. Warden -- *Chair, President, and Chief Executive Officer*

Well, Scott, I think that's exactly what the Air Force is looking at. They are undertaking a force structure design review and the Secretary has been open about looking at the various options they have for increasing Air Force size and has talked specifically about NGAD. And we know that B-21 is in the mix as well. It would be premature for me to suggest where that for structure review will end up.

But I do think in the coming months, we may get a better indication from the Air Force as to how they're thinking about B-21 quantities in the long run. In the short run, we remain very focused on delivering them optionality. The performance that we are delivering gives them a capability that is in production now that is well below the cost target for the platform. And we believe that that's the role of industry to give the government options as they think about their force structure.

Scott Mikus -- *Melius Research -- Analyst*

Thanks for taking the question.

Kathy J. Warden -- *Chair, President, and Chief Executive Officer*

Thank you. Well, let me close by thanking the Northrop Grumman team for another outstanding quarter. They are executing our strategy. And importantly, that means that they're providing the capabilities our customers need in this incredibly dynamic environment that they face.

I also just want to take a moment to thank Cai von Rumohr and George Shapiro neither of whom are on the call today. But I think you all know that retiring after respectively, 55 and 43 years of covering this industry, which is just amazing. And we've truly enjoyed working with them both and who miss their expertise and commitment to this industry. So -- in addition, I do want to congratulate Dave on his retirement, not quite 55 years in the industry, but the five years with our company have been truly outstanding and wish you all the best in your retirement.

So thanks to all of you for joining our call. We look forward to talking to you again January, if not before.

Operator

[Operator signoff]

Duration: 0 minutes

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