Lockheed Martin (LMT) Q2 2024 Earnings Call Transcript

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LMT earnings call for the period ending June 30, 2024.

Lockheed Martin (LMT 4.30%)

Q2 2024 Earnings Call

Jul 23, 2024, *11:00 a.m. ET*

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IMAGE SOURCE: THE MOTLEY FOOL.

Prepared Remarks:

Operator

Good day, and welcome, everyone, to the Lockheed Martin second-quarter 2024 earnings conference call. Today's call is being recorded. [Operator instructions] At this time, for opening remarks and introductions, I would like to turn the conference over to Maria Ricciardone, vice president, treasurer, and investor relations. Please go ahead.

Maria Ricciardone -- *Vice President, Treasurer, and Investor Relations*

Thank you, Lois, and good morning. I'd like to welcome everyone to our second-quarter 2024 earnings call. Joining me today on the call are Jim Taiclet, our chairman, president, and chief executive officer; and Jay Malave, our financial officer. Statements made in today's call that are not historical facts are considered forward-looking statements and are made pursuant to the Safe Harbor provisions of federal securities laws.

Actual results may differ materially from those projected in the forward-looking statements. Please see today's press release and our SEC filings for a description of some of the factors that may cause actual results to differ materially from those in the forward-looking statements. We've posted charts on our website today that we plan to address during the call to supplement our comments. These charts also include information regarding non-GAAP measures that may be used in today's call.

Please access our website at www.lockheedmartin.com and click on the Investor Relations link to view and follow the charts. With that, I'd like to turn the call over to Jim.

James D. Taiclet, Jr. -- *Chair, President, and Chief Executive Officer*

Thanks, Maria. Good morning, everyone, and thank you for joining us on our second-quarter 2024 earnings call. Over the past few months, Lockheed Martin's people, systems, and platforms have again demonstrated their ability to enhance security in Eastern Europe, the Red Sea, and the Middle East. From the PAC-3s critical role in air defense, to the Aegis Combat System with AI augmentation to the F-35 of this advanced sensor and data management capabilities, our company has made major contributions to Allied and Partner defense.

We continue to demonstrate the impact of our 21st-century security strategy by harnessing the latest digital technologies to continuously improve mission effectiveness, strengthening and scaling defense production system, and expanding industrial cooperation among our allies and partners. Consequently, demand for our defense technology solutions remains robust, with a backlog of nearly $160 billion greater than two times our annual revenue. Our strong performance so far in 2024 extends beyond blast backlog as well giving us confidence to raise our 2024 full-year outlook for sales, segment operating profit, and EPS. In the second quarter, sales increased 9% year over year and 5% sequentially and reflected growth in all four of our business segments.

The supply chain continues to improve and defense outlays also continue to increase. Our focus on operational execution helped us achieve segment operating margins of 11.3%, up 20 basis points compared to last year's second quarter, and free cash flow of more than $1.5 billion, an increase both year over year and sequentially. Jay and Maria will talk more about the specifics of the quarterly results in a moment, but suffice it to say, we are pleased with our financial performance and momentum so far in 2024. I'm especially happy to report the progress we have made on the F-35 program.

As announced last week, we began deliveries of the first Technology Refresh 3 or TR-3 configured F-35 aircraft to the U.S. government. The TR-3 upgrade and further Block 4 enhancements represent a critical evolution in capability and their full development remains a top priority for us. These and further software updates over the life of the program will ensure that F-35 remains an effective deterrent to aggression and the cornerstone of Joint All-Domain operations now and decades into the future.

We continue to produce at a rate of 156 aircraft per year and expect to deliver 75 to 100 aircraft in the second half of 2024. Over 95% of TR-3 capabilities are currently being flight-tested and we look forward to delivering full TR-3 combat capability to the customer. In addition, we expect deliveries of F-35 aircraft to exceed production for the next few years. Jay will talk about the financial aspects of our current status in a moment.

Continued close collaboration with the joint program office, or the JPO as known, and across our industry partners has been and will be essential to meet and exceed expectations of this critical national defense program in a timely and cost-effective manner. I met with my F-35 industry CEO colleagues in Fort Worth recently to set plans for enhancing the cooperation on our software and hardware and test integration processes, among other initiatives to increase speed and efficiency in the program. The TR-3 hardware and software provide a significant upgrade in computing power that enables major improvements and capability to our airmen, sailors, and marine as well as to our partner and allied nations. International customers continue to recognize the superior capabilities of this, the most advanced fighter aircraft in the world in key aircraft node in the DoD's Joint All-Domain architecture.

On the international front, Israel announced a third squad of F-35As, increasing their fleet by 50%. Greece is in the final stages discussion with the U.S. government to procure the F-35 and we continue to see interest from Romania as well as a potential new customer. Beyond the F-35 is the quarterback of Joint All-Domain operations our ongoing collaboration with the U.S.

military during major exercises with deployed operational units exemplifies our commitment and ability to enhance readiness and integrate capabilities across all of our customers' missions and priorities. In June, new advanced capabilities from across Lockheed Martin contributed to the tenth iteration of U.S. Indo-Pacific Command's Valiant Shield exercise. During this exercise, there were several significant milestones demonstrating how we are continually improving our forces capabilities and enhancing our deterrence posture.

One example is that we successfully integrated digital command and control capabilities with the Indo-Pacific Command's Joint Fires network, enhancing real-time decision-making commanders and operational agility for the forest. Our operational planning data fusion engine was employed to coordinate joint operations using live real-time data producing actual tasking orders at combat-relevant speed. And another example from the same exercise, Lockheed Martin Space and Lockheed Martin Aeronautics jointly demonstrated the ability to autonomously optimize intelligence, surveillance and reconnaissance, or ISR, collection and enhance their imagery for quick, automated target detection and classification, facilitating data delivery across a wide range of space-based and airborne platforms like never before. In addition, the U.S.

Army tested our Precision Strike Missile, or PrSM, against the moving maritime target in the Pacific Ocean. This next-generation missile enables further improved range and precision to deter potential adverse series from even greater distances. According to the Army, this test is a significant step in the PrSM programs progress. We've also moved toward realizing the 21st-century security Joint All-Domain vision with the signing of a landmark agreement with Australia's Department of Defense to build their future joint air battle management system.

They call it Project AIR6500 Phase 1. As we've discussed before, this system will provide the Australian defense force with leading-edge integrated air and missile defense capability using next-generation technologies to combat high-speed threats and establish Australia's integrated air and missile defense as one of the most highly advanced in the world. We also continued to demonstrate 21st-century security in other innovative ways. In May, our Skunk Works Tactical artificial intelligence team successfully executed their second set of flight tests with the University of Iowa's, Operator Performance Laboratory.

RAI flew an L29 jet aircraft by means of heading, speed, and altitude command sent directly to the onboard autopilot than to the plans flight controls. This test has shown our AI team can rapidly develop, iterate, and integrate artificial intelligence technology for autonomous flight operations. We're also making great progress in another leading-edge defense tech initiative, hypersonic strike, which is a critical element of deterrence in today's world. As announced by the Department of Defense in June, the U.S.

Navy and U.S. Army completed an end-to-end all up ground flight test of a common person missile, core to the Navy's conventional prompt strike or CPS and the army's long-range hypersonic weapons programs. The test marked a major step forward for the nation's development of hypersonic systems by Lockheed Martin. Pivoting to the supply chain, we continue to explore opportunities to drive our concept of anti-fragility across the global defense industrial base.

For example, we recently signed a collaborative memorandum of understanding with Ryan Mittal to work together on land, air, and naval opportunities. One of our first initiatives is the new Global Mobile Artillery Rocket System or GMLRS is a highly interoperable two-pod launcher system intended to fire the MLRS-based munitions. Combining these combat-proven systems will help address the growing demand for long-range rocket capabilities in Europe and elsewhere. On our PAC-3 program, international collaboration remains strong as well, including development of indigenous capabilities with the opening of a PAC-3 MSE launch tube production line in Poland, as well as a memorandum of understanding with Grupo Oesía in Spain to provide an opportunity to manufacture factory MSE parts for worldwide customers.

Spain and the United States also formalized an agreement for Spain to purchase pack-free MSE missiles and related support, making Spain PAC-3s 16th partner nation. I'd also like to briefly discuss the latest status of the U.S. defense budget. The House approved their version of the FY '25 defense appropriations.

So the focus now shifts to the Senate where the process continues before the reconciliation phase later this year. We believe our portfolio is well-aligned to current and future customer mission priorities, including air superiority with the F-35 and CH-53K and Black Hawk or UH-60M. Our integrated air and missile defense with PAC-3 and NGI, hypersonics with CPS and the LRHW I just mentioned a minute ago, and tactical strike weapons and munitions with JASSM, LRASM, PrSM, Javelin, and GMLRS. Ultimately, we look forward to the conclusion of the USG appropriations process and the continued utilization of the existing supplement mental funding.

On the international front, I was encouraged by conversations I had at the recent NATO Summit a few weeks ago in Washington. International partners and allies remain steadfast in their pursuit of elevated defense spending to strengthen the overall integrated deterrence posture of the alliance given the tragic and ongoing conflict in Ukraine. I'll now turn it over to Jay for award highlights and additional commentary on our financial results.

Jesus Malave, Jr. -- *Chief Financial Officer*

Thanks, Jim. Similar to last quarter, I'll provide an overview of consolidated financials and touch on a handful of operational items before handing off to Maria, who will cover business area financials, and then I'll come back to discuss the updated outlook. Starting on Chart 4. The positive momentum we had to begin the year continued into the second quarter with sales up 9% to over $18 billion, led by RMS and MFC.

As Jim mentioned, throughput remained strong reflecting an improving supply chain and internal operating cadence. Segment operating profit of $2 billion was up 10% year over year, and consolidated margins were 11.3%. With all four business areas achieving double-digit return on sales, the first time since the third quarter of 2022. Net favorable profit adjustments in the quarter were higher than prior year and were 21% of segment operating profit, driving the stronger margins.

GAAP earnings per share of $6.85 increased 3% year over year, driven by higher profit and lower share count, partially offset by severance impairment charges at RMS and Sikorsky, higher interest expense, and lower pension income. On the new business front, we recorded over $17 billion of orders in the second quarter for a book-to-bill ratio just below one. We generated $1.5 billion of free cash flow in the quarter, bringing our year-to-date total to just under $2.8 billion, and we continue to make the necessary investments in innovation and infrastructure to position the company and our customers for future success with $400 million -- $405 million in research and development and $370 million in capital expenditures the second quarter. Finally, we returned over 100% of our free cash flow to shareholders via share repurchases and dividends.

Now, I'll touch on a few business activities in more detail. The order strength continued at MFC with a book-to-bill over two in the quarter, led by the $4 billion-plus Army award spanning multiyear PAC-3 delivery requirements and supporting our production ramp projections. And Poland officials signed a letter of acceptance to purchase 400 JASSM ERs, the largest international order and program history, providing another ally with the latest generation JASSM variant. At Sikorsky, its platforms remain in high demand as the U.S.

State Department announced approval for four foreign military sales of Black Hawk to Austria, Brazil, and Sweden. This opens the door to the potential sale of 36 Black Hawks, adding 12 helicopters each to each country's existing Blackhawk fleet. In addition, the government of Greece signed a letter of offer and acceptance for 35 UH-60M Black Hawk helicopters. These upgraded aircraft will support the Hellenic Ministry of Defense's ongoing modernization.

It will serve as a dependable multi-role helicopter with unmatched interoperability to support vital national and allied security missions. In the space domain, late last month, NASA selected Lockheed Martin to develop and build the nation's next-generation weather satellite constellation for NOAA known as Geostationary Extended Observations, or GeoXO. This award builds on our prior work with environmental sensing technologies, which recently culminated with the launch of GOES-U, which will leverage advanced instruments and rapid updates to provide crucial data for weather forecasting, severe storm tracking, and climate monitoring. Let me stop here and hand it over to Maria to get into the business area of financial detail.

Maria Ricciardone -- *Vice President, Treasurer, and Investor Relations*

Thanks, Jay. Today, I'll discuss second-quarter year-over-year results for the business areas, starting with Aeronautics on Chart 5. Second-quarter sales at Aero were up 6% year over year. The increase was primarily due to higher volumes across F-35 and the continued production ramp on the F-16 program.

Segment operating profit increased 5% with higher volume and favorable mix being offset by lower profit booking rate adjustments. Regarding aircraft deliveries, we resumed F-35 deliveries in Q3, as Jim shared, and we've delivered our 1,000 F-35s. On F-16, we delivered four in the second quarter and are targeting around 20 for the year. For 130J, we delivered five in the quarter, reaching a milestone of 2,700 deliveries of this critical tactical airlifter, and expect around 20 deliveries for this year.

Turning to Missiles and Fire Control on Chart 6. MFC had another strong quarter with sales up 13% from the prior year, driven by production ramps on a handful of our precision fires programs within the tactical and strike missile segment, primarily Guided Multiple Launch Rocket System, GMLRS, and Long Range Anti-Ship Missile, LRASM. Segment operating profit increased 21% year over year due to higher profit booking rate adjustments led by the PAC-3 and Apache programs margins returned to 14.5%, which is more in line with historical rates. MFC backlog reached a record level of almost $35 billion in Q2 supported by continued global demand for several of our missile ammunition programs.

Key awards included the PAC-3 award that Jay mentioned as well as $1.3 billion in combined awards for launchers, including HIMARS, and M270 upgrades, and a $500 million follow-on production contract for JAGM and Hellfire to support U.S. and international customers. On the delivery front, I'll highlight a few of the key program quantities in the quarter. We delivered 100 PAC-3 interceptors, more than 2,000 GMLRS rockets, over 2,700 Hellfire missiles, and 11 HIMARS systems.

Shifting to rotary emission systems on Chart 7. Sales increased 17% in the quarter to over $4.5 billion primarily driven by higher volume at integrated warfare systems and sensors on radar and laser programs as well as the Canadian Surface Combatant program. Sikorsky programs also saw higher volume led by Black Hawk and CH-53K. Also of note in the quarter, we delivered five S-70 helicopters to international customers, which resulted in about $115 million of revenue on a passage of title POT basis.

Operating profit increased 9% year over year due to higher volume, partially offset by lower profit booking rate adjustments. Now, for a brief summary of helicopter deliveries. In addition to the five S-70 helicopters I mentioned, Sikorsky delivered five Black Hawks, four combat rescue helicopters, and one VH-92 Presidential helicopter in the quarter. On the delivery front, a few of the key program quantities in the second quarter, we -- yes, sorry about that.

Let's go to space. Finally, with space on Chart 8. Sales increased 1% year over year. The growth was driven by higher volume on strategic and missile defense programs, primarily hypersonics and Fleet Ballistic Missile, FBM.

Partially offsetting this growth was lower volume on classified programs and Orion. Operating profit increased 11% compared to Q2 2023, driven by favorable mix and higher profit booking rate adjustments. Now, I'll turn it back over to Jay to wrap up our prepared remarks.

Jesus Malave, Jr. -- *Chief Financial Officer*

All right. Thanks, Maria, and let's shift over to the outlook on Chart 9. Given our strong year-to-date performance, sustained back position, and improving visibility into key programs, we're raising our expectations for Lockheed Martin's 2024 financial outlook for sales, segment operating profit, and earnings per share. We're increasing sales by $1.75 billion at the midpoint and tightening the range to $70.5 billion to $71.5 billion.

The new midpoint reflects a solid 5% growth from 2023 with increases across all four business areas. We're also increasing segment operating profit expectation based on the higher sales with the new range of $7.35 billion to $7.5 billion and anticipate consolidated segment operating profit margins to remain at 10.5%. Business area margins remained consistent with our prior guidance at Aero and MFC, while RMS is down about 50 basis points at the midpoint and space is up 40 basis points at the midpoint. The RMS reduction is driven by Sikorsky as the business faces continued cost pressure and absorption headwinds, the impact of which have exceeded benefits from its cost reduction programs.

Conversely, space is benefiting from solid performance and proactive reduction efforts. Moving to earnings per share on Chart 11. We're increasing the midpoint by $0.35 to $26.35 with a range of $26.10 to $26.60 for the full year. Primary drivers of the change are shown on this chart with increases coming from incremental profit of $0.49 and other below-the-line items of $0.13.

Partially offsetting those items are the RMS charges totaling $0.29 and from the severance actions and the asset write-downs taken in the second quarter. As Jim mentioned, we're encouraged by the F-35 delivery restart and continuous progress being made toward delivering full combat capability. We're holding our free cash flow expectation in the range of $6 billion to $6.3 billion, which absorbs a potential unfavorable impact from longer deferrals of final F-35 delivery payments. This is made possible by proactive actions taken across the company to offset these potential headwinds.

On the cash deployment side, we still expect over $3 billion of IR&D and capital investments, while the dividend, along with the expected $4 billion of share repurchases, maintain attractive shareholder returns. Lastly, on backlog, we continue to expect backlog to grow in 2024 even with the higher sales outlook, which provides a line of sight to future growth. Before I wrap, I'd like to highlight a few other key assumptions regarding the updated outlook. First, we expect F-35 18/19 to be awarded this year, maintaining program funding and continuity.

Second, we continue to expect $325 million of losses on the MFC classified program, of which $100 million has been recognized year to date. And third, this outlook does not assume any pension contributions in 2024. So in summary on Chart 12, our solid first-half results give us confidence in raising the full-year outlook for sales, profit, and EPS, while holding the cash flow outlook, reflecting our ongoing efforts to deliver predictable, and improving operating and financial performance as is expected of us. It all starts with a relentless focus on executing to our programmatic commitments and delivering critical 21st-century security mission capabilities where we strive to continuously improve.

To that end, we are investing in our people, processes, and systems through the 1LMX transformation, with the goal of unlocking step changes in efficiency, velocity, and program execution that delivers security capabilities in ahead of ready speed to our customers. And we're confident that these management priorities and actions convert to a compelling long-term value proposition for customers and shareholders alike. With that, Lois, let's open up the call for Q&A.

Questions & Answers:

Operator

Thank you [Operator instructions] The first question comes from the line of Kristine Liwag from Morgan Stanley. Please go ahead.

Kristine T. Liwag -- *Analyst*

Hi, Jim, Jay, and Maria. Release from Farnborough, the F-16 is flying in the background right now. So apologies for the grower in the background.

James D. Taiclet, Jr. -- *Chair, President, and Chief Executive Officer*

Let's call it the sound of Freedom, Christine, it's good.

Kristine T. Liwag -- *Analyst*

I mean, it's a crazy or beautiful aircraft here. So the delivery guidance for the F-35 in the second half of this year is still fairly wide. Can you talk about the scenarios where there are lower and upper? What would have to happen for you to hit the lower upper end of the range? And also with production at 156 per year, when should deliver and production catch up for the program?

James D. Taiclet, Jr. -- *Chair, President, and Chief Executive Officer*

So, Kristine, I'll start and emphasize that we're going to do this unwind and conduct the deliveries with safety and quality is our No. 1 priority. So just starting with that foundation, we actually have the ability to add resources, which have already been identified and designated. And that's test pilots, maintenance team, software and hardware engineers to get the flight test done that we need to, be at the higher end of that range.

But we want to make sure that if it's weather, if it's pilot, crew rest issues, anything like that, we will accommodate for those. But we should -- we have the resources in place, I'll say, that should enable us to get to the higher end of that range, if you will.

Jesus Malave, Jr. -- *Chief Financial Officer*

Yeah. Let me just add, just to reiterate, Kristine, we expect anywhere between 75 to 110. Yes, with less than six months left, it is a wide range. I would say, over the next few months, we'll get much better insights into the induction and flow of aircraft going into the test and production cycle, really bringing in aircraft that are parked as well as aircraft that are coming outside of the -- from the production flow.

And as we get those learnings, we'll be able to get a better assessment what the delivery requirements will be and what we expect for the year. And so it will take us a couple of months just to make sure we get that process learned out. It's well planned, but we actually have to demonstrate it in actual practice. As far as the future, from terms of reducing on the backlog of aircraft, our target is anywhere between 12 to 18 aircraft deliveries per month and really to burn down the aircraft backlog.

And so that will take us a number of years here to get through that. We've already made progress so far. Since the announcement of the restart, we've delivered 10 aircraft as of Monday yesterday, six with the TR-3 configuration and four with the TR-2 configuration. So we think we're off to a very good start.

But again, we really need to have a -- just to monitor the operating cadence of being able bring aircraft from two different flows into one test -- flight test flow. And again, we'll tighten that up later on in the year.

Operator

Thank you. The next question is from Cai von Rumohr from TD Cowen. Please go ahead.

Cai von Rumohr -- *Analyst*

Yes. Thanks so much. So I think you did say that next year, you're going to deliver more F-35s than you will produce. And I think at one point, you mentioned that you get paid $7 million upon each delivery.

Walk us through -- you mentioned also the deferral of some payments. So next year, what happens to accrued revenues, because I think with higher deliveries, I assume the final delivery payment basically is incremental even though under POC, the work itself should be relatively level. And then secondly, the cash flow impact. I know that there's a deferral on the payments, but if it was really $7 million, that's potentially a substantial cash flow plus.

Thanks so much.

Jesus Malave, Jr. -- *Chief Financial Officer*

OK. Cai, let me just say, first of all, as Jim mentioned, restarting delivery was an important first step really toward delivering the fully combat-capable aircraft. Aircraft, the withhold -- the aircraft withhold this final delivery payment is a timing item, as you mentioned. And we're working with the customer to finalize the terms of those final delivery payments.

We're making excellent progress, but it would be immature or premature to give details of that because it remains subject to negotiation. Suffice it to say that you will see timing benefit over the next few years as we deliver, but I think we still need to work through and finalize this agreement with the customer. As far as the revenue, I really wouldn't see -- expect much of an incremental benefit in terms of revenue. We continue to build at a 156 rate.

We are seeing production a little bit higher this year. But for the most part, we should expect that to be, I think, fairly stable. And yes, we'll see incremental activity in terms of test activity, which does increase penetration on a percent complete basis. But I don't really view that being all that material.

And so we just hold the production. We'll expect F-35 to grow mostly from sustainment next year and in the years to come. I think it's important to mention as well that we are -- the headwind on funnel delivery payments are here in 2024. We're holding our outlook, so we're absorbing that with better performance in the rest of the portfolio.

Yes, we will see the timing benefits downstream. But as I mentioned before, we have to get just the whole delivery cadence straight. And I just want to make sure I had it straight in terms of the last question. We're targeting anywhere between 12 to 18 months to fully deliver on these parked aircraft.

And as I mentioned, we just need to learn out the process over the next few months here and get -- to be able to give better guidance on that.

Cai von Rumohr -- *Analyst*

Thanks so much.

Operator

Thank you. Our next question is the line of Scott Deuschle from Deutsche Bank. Please go ahead.

Scott Deuschle -- *Deustche Bank -- Analyst*

Hey. Good morning.

James D. Taiclet, Jr. -- *Chair, President, and Chief Executive Officer*

Good morning.

Scott Deuschle -- *Deustche Bank -- Analyst*

Jay, you've been seeing some nice momentum on revenue and now you're seeing some of it on margins as well. I guess at what point do you think you'll be ready to start talking about maybe a better medium-term free cash flow per share growth outlook in this mid-single-digit rate you've been talking about for a while. Do you just need to let these pension headwinds next year and see a bit more growth acceleration? And then you're there. Just curious for how you're thinking about that? thanks.

Jesus Malave, Jr. -- *Chief Financial Officer*

Yeah. No, I appreciate the question. We've said over the last few months and really the last year or so that our goal has been to increase absolute free cash flow in the low single-digit clip, and then that augmented with share repurchase would get us to a mid-single-digit free cash flow per share expectation. That remains of the outlook.

We'll go through our multiyear forecast over the next few months here, we'll be able to give you a better update in the October timeframe. I think given the fact that we're at a higher level in 2024 is a positive, and we continue to expect to grow in 2025 off this higher baseline. So that in and of itself should result in a higher cash flow baseline as well. But there's a lot of work to be done between now and then.

And so I would like to have the benefit of going through that in more detail, and we'll update that to you at least preliminarily in October.

Scott Deuschle -- *Deustche Bank -- Analyst*

That's great. Thank you.

Operator

Thank you. The next question is from Gavin Parsons from UBS. Please go ahead.

Gavin Parsons -- *UBS -- Analyst*

Thanks. Good morning.

James D. Taiclet, Jr. -- *Chair, President, and Chief Executive Officer*

Good morning.

Gavin Parsons -- *UBS -- Analyst*

Maybe sticking on revenue. You guys have talked about supply chain kind of being a bottleneck, is the upside more on the demand front or on the unlocking of the supply chain side? And if latter, can you just talk a little bit more about supply chain and what you expect going forward in the second half, because I think the second half a lot less growth?

Jesus Malave, Jr. -- *Chief Financial Officer*

Well, I'd say it's a combination of both. We ended the year in 2023 with a $160 billion backlog, which was a record. We ended here in the second quarter at $158 billion was slightly below where it ended a record with significantly higher sales than we thought through the first half of the year. We expect -- our continue -- as I mentioned in my prepared remarks, that we continue to expect the backlog to increase at end of this year, which gives us more visibility into further growth in 2025 and beyond.

So we're very bullish on where that stands from a backlog standpoint. As far as supply chain, we did see improvement. We are seeing continued improvement there and on-time delivery. The part shortages continue to come down.

Having said that, there are still areas where we're -- particularly where we're ramping up some of our major programs where we still have some work to be done there. And we're still going through many of the initiatives and actions that -- proactive actions that we've talked about in the past, which is some in-sourcing on some capabilities, dual sourcing, where it makes sense. Also, we have deployed, and we continue to deploy personnel to provide on-site assistance at our suppliers. And of course, we also continue to look at product redesign.

But I'd say, by and large, we are seeing an improvement in the in the supply chain, which also gives us confidence for that continued growth in the future.

James D. Taiclet, Jr. -- *Chair, President, and Chief Executive Officer*

And Gavin, I just give you some qualitative background on demand side. Our strategy includes driving the latest digital technologies kind of through an open architecture, standard-based system to the DoD. And by doing that and making our product services platforms compliant or in line with those future concepts of open architecture and standards to pull through those products, services, and platforms. So we're starting to see that already.

And we're demonstrating whether it's exercises or in real conflict like the Red Sea, doing things like over-the-air updates to the Aegis system, which is decades old, but it can be improved very quickly now just like when you download overnight on your Tesla, we can do a download overnight over the air on the Aegis radar and combat control system and double, triple the effectiveness against things like low flying drones and cruise missiles. So we're actually implementing those kinds of things on a standard base architecture into our products and services today, which I expect will continue to pull them through.

Gavin Parsons -- *UBS -- Analyst*

Great. Appreciate the detail.

Operator

Thank you. Our next question is from Pete Skibitski from Alembic Global. Please go ahead.

Peter Skibitski -- *Analyst*

Hey. Good morning, guys. Guys on missiles and fire control, if you think about what was appropriate in the 2024 baseline budget and the Ukraine supplemental, how much order flow is still to come there for you guys at MFC? And also, just if we think about the growth cadence there, you talked about $750 million a year in the past, you're going to be well above that this year. So I'm just wondering if that cadence is going to come back into play 2025 on a higher baseline.

Thanks.

Jesus Malave, Jr. -- *Chief Financial Officer*

Sure. I mean there's still plenty of runway in orders at MFC. As I mentioned, the book-to-bill in the quarter was above 2%, and we're still expecting additional orders at the end of the year, particularly in JASSM/LRASM in second half here. They're still even under supplemental, there's some opportunity there to continue to build their backlog and so we've talked about $750 million.

You're right. They're going to be above that this year. We see continued growth there next year, and they're going to be, again, the highest grower within Lockheed Martin for the next three to five years. So we're pretty bullish on that.

Much of that is already in the backlog, but there's still plenty more to come in terms of build -- continuing to build that backlog. The key for us is to make sure that we can meet the demand and ramp up all these programs to our customers' requirements. And the team has been laser-focused on making sure they can do that, and you're seeing the benefits of that this year with the sales coming in higher. So again, we keep our head down, continue to deliver.

The demand is both domestic and international at MFC. And again, they're going to be a significant source of growth for Lockheed Martin or for the next three to five years.

James D. Taiclet, Jr. -- *Chair, President, and Chief Executive Officer*

And Pete, it's Jim. Again, on a qualitative perspective, I tell our teams and our executives internally we're in the aerospace and defense industry, but we're in the deterrence business. right? So if you step back and say what contributes to deterrence from an MFC, for example? And I think anybody that's everyone watching Clint Eastwood would movie will know that, if we run out of ammunition, you're in a lot of trouble, right? So part of deterrence is showing that, a, you have enough ammunition stocks to prevail and sustain your operations from an aggressor. That's the first thing.

Second thing is you also -- it's helpful to demonstrate that you can produce at rate and ramp that rate quickly. That's our anti-fragility program. And the third piece of it is you can produce and repair MFC and other products in the local theater and not have to bring them all the way back to the U.S. to fix them or drive that production up.

That's the third part of our strategy. So everything we do is based on deterrents and strengthening that. And MSC has a huge role in making sure that adversaries know that we've got enough stocks in MFC-type products, and we can ramp that rate and we can produce in different places and repair in different places should they act. And that's really kind of a qualitative underpinning of what Jay was talking about.

Peter Skibitski -- *Analyst*

Appreciate it guys.

James D. Taiclet, Jr. -- *Chair, President, and Chief Executive Officer*

Thank you.

Operator

The next question is from Seth Seifman from J.P. Morgan. Please go ahead.

Seth Seifman -- *Analyst*

Hey. Thanks very much and good morning. Probably just a quick one. Sorry about the background noise here.

Just a quick one and kind of big picture. I think, Jay, I think you've said in the past that there was good potential for growth to be at least as strong as 2024 and 2025 and good potential for that growth rate to accelerate. Is that still the case off of the higher revenue base and a higher growth rate here in 2025 -- in 2024?

Jesus Malave, Jr. -- *Chief Financial Officer*

Yeah. It's a good question, Seth. And as I mentioned before, we're going -- just going through our process to lay out our multiyear outlook, including 2025 here over the next few months. What I would tell you is that the backlog visibility that we have would support another year similar to 2024.

We have to have to go through though, and the operational. The practical operational capability to deliver that is something we go through. And so the demand is there. We have to make sure the supply can meet that as well.

That's a pretty significant step change over really a two-year span on some of these ramp programs that we're dealing with. And as I mentioned before, we're still dealing with some programs that are still working through trying to get off to the ramp rates.

Operator

Our next question is from Sheila Kahyaoglu from Jefferies. Please go ahead.

Sheila Kahyaoglu -- *Analyst*

Good morning, guys. Thank you. Maybe if we could talk about profitability. If we look at first half profitability of 10.7, second half implied in the low 10s.

Can you walk through some of the moving pieces, maybe in terms of supply chain productivity, I know volumes are lower and how we think about the exit rate for the year?

Jesus Malave, Jr. -- *Chief Financial Officer*

Yeah. The second half of the year, Sheila, is -- I mean the most significant would be the program loss at MFC that we have to record in the second half. So as I mentioned in my prepared remarks, we recorded about $100 million here year to date. In the second half, we expect about another $225 million.

So that will put pressure on margins in back half. The second piece I would say is that, we would have -- even though we had a very strong and solid profit adjustment first half that slows down a little bit in the back half of the year just based on program timing, the timing of risk retirements -- and so just the risk retirements and profit adjustments are not all linear, they incur different aspects of a program life cycle. But what I would say is we feel comfortable with where we're headed. We've talked about 2024 being a low watermark for all net-net margins, and we expect it to improve gradually over the next few years, and we still feel confident that can take place.

Sheila Kahyaoglu -- *Analyst*

Thank you.

Jesus Malave, Jr. -- *Chief Financial Officer*

All right.

Operator

Thank you. The next question is from Ken Herbert from RBC Capital Markets. Please go ahead.

Kenneth Herbert -- *Analyst*

Yeah. Hi. Good morning. I just wanted to see and apologies if I missed this, but can you comment on your view of NGAD, and how you're thinking about that now moving forward? And what we might be thinking about in terms of the next catalyst for you on this particular program?

James D. Taiclet, Jr. -- *Chair, President, and Chief Executive Officer*

Sure, Ken. It's Jim here. So when it comes to NGAD as a program, we're not authorized an industry to speak to the details of that. So you'd have go to the U.S.

government to get insight into that particular program. But I can tell you what we're doing to prepare for the next-generation combat aircraft. So on the investment front, since 1920 -- or 2021 rather, we opened the gates on four high-tech facilities that have the clearance -- the security clearance capability to produce NGAD-type components, let's call them, all right? One of them is in Florida, Skunk Works in California, opened a new major factory that I was there to see. We have it in Alabama, two in Georgia.

So we have these accredited facilities up and running ahead of the demand, and we're working on programs and products in that classified capability space. So we've already got these facilities up and running. The other resource we have is human in Skunk Works, Marietta and in Fort Worth, and other places that can design, test and build using our digital transformation engineering technologies and the digital twin these kind of components, aircraft, and others that might go into a NGAD concept. So I can just tell you that Lockheed Martin is ready to produce.

We're ready to design. We're ready to build. We are in the process of making sure we're capable in the arenas that the Air Force and the Navy are going to need us to be. So that's really all we can say about that.

But I can assure you that we are competitive and ready to go in this space if and when the government pulls a trigger on a real competition and want somebody will be able to produce, we can do it.

Operator

Thank you. And the next question comes from the line of Rob Spingarn from Melius Research. Please go ahead.

Robert Spingarn -- *Analyst*

Hey. Good afternoon, or I guess, it's still morning. But I wanted to ask you about on F-35 and congrats on the resumption of deliveries. But when we think about TR-3 and on the production side of the equation, how is the supply chain in terms of being able to supply enough material and integrated core processors on time for you to maintain the 156 per year.

So as the mix goes more toward all TR-3, how well prepared is the supply chain for that?

James D. Taiclet, Jr. -- *Chair, President, and Chief Executive Officer*

So we got together, Rob, as I mentioned a few minutes ago in the prepared remarks in Fort Worth about a month with the CEOs of half of those companies that contribute to this in a significant way. We communicated the importance of exactly what you're speaking to which is not just a core processor, but there's a range and a number of other components across all of these companies that need to maintain or increase their production rates and modernize their equipment along the way. And so that communication of those suppliers has been made. They know our plans were well integrated -- more integrated than we ever have, I think, when it comes to test and planning and design iterative software across multiple companies, et cetera.

So we're in a position, and as suppliers are telling us they will meet the demand. We will monitor them and continue to even put people in their sights when we need to, to make sure that happens. But we've got the major suppliers together, and they understand the demand rate, quality level we need and a better integration plan for test and development that we have built going forward.

Robert Spingarn -- *Analyst*

And Jim, just following on to that, how do we think about the cadence for retrofit from TR-2 to 3?

James D. Taiclet, Jr. -- *Chair, President, and Chief Executive Officer*

So you're right, Rob, that this is designed for backward integration, if you will. There'll be a schedule that the U.S. government. It comes up with for TR-3.

There may be -- it will be up to them as to the cadence, the investment rate, et cetera. But over a period of time, there will be a great number of originally built TR-2 aircraft that will get converted. There's some hardware software upgrades to that.

Robert Spingarn -- *Analyst*

Is this the kind of thing you expect to be talking about soon? Or this is a few years out, we should be focusing on new production aircraft for now TR-3.

James D. Taiclet, Jr. -- *Chair, President, and Chief Executive Officer*

Yes. So again, this is a U.S. government policy decision, so it's better to request that kind of commentary from them, Rob. But we're, again, ready to do it at the rate that we expect -- that they come at us with.

Robert Spingarn -- *Analyst*

Great. Thanks, so much.

James D. Taiclet, Jr. -- *Chair, President, and Chief Executive Officer*

Thank you.

Operator

The next question is from Noah Poponak from Goldman Sachs. Please go ahead.

Noah Poponak -- *Analyst*

Hey. Good morning, everyone.

James D. Taiclet, Jr. -- *Chair, President, and Chief Executive Officer*

Good morning.

Noah Poponak -- *Analyst*

Jay, could you give us the updated -- I guess, if you snap the line today or just ballpark as you see it, cash flow, pension contribution in CAS recovery for at least '25, and I guess if you had it, and we're willing to give it beyond that would be helpful. And then I guess, can you talk through the pieces of how you grow absolute dollar free cash flow in '25, given the pension headwind you have and how it compares to how quickly you can grow the segment EBIT.

Jesus Malave, Jr. -- *Chief Financial Officer*

Yeah. So on CAS recovery, this year, we're a little bit under, say, $1.7 billion. We expect that to step down by -- in the range of about $100 million and probably stay at that level for the next few years after that. As far as absolute free cash flow in terms of the buildup and components to being able to continue grow, yes, we've talked about pension being a headwind.

We've talked about being in the range of about $1 billion. The areas that we expect to drive cash flow growth would be continued earnings growth as you discussed their net income growth, in addition to some of these benefits and the timing on the F-35. We've talked also about just working capital in general. And even when you put F-35 aside, what we're looking at and going after is our contract asset.

If you look here in the second quarter, that was a nearly $14 billion balance that we had net represented in a range and I'll put that in terms of efficiency around 70, 72 days of sales running through the balance at the moment. Since 2020 or so, that's grown from about 55 days. So there's an element of there kind of the F-35 and what we've gone through over the past couple of years here, but there's also been growth outside of the F-35 that represents a lot of opportunity for us to convert into faster billings at a level that we've been we've been able to demonstrate in the past. And that's what focused with on all of the business areas in terms of driving that on a multiyear basis back down to what we've been able to demonstrate.

The next thing I'll say, so besides working capital and contract assets that are biggest opportunity is the reduction of payments related to the tax R&D capitalization. So we'll get in the range, I'd say, about $150 million of benefit just through lower payments there. So when you bring all these things together, we think that they generate a path to overcome what we're seeing in the pension and drive us to this target of low single digit. It's not easy.

It's not a slam dunk, but we've got a path to be able to do that, and that's what we're driving today to be able deliver next year and beyond.

Operator

Thank you. The next question is from the line of Peter Arment from Baird. Please go ahead.

Peter Arment -- *Analyst*

Thanks. Good morning, everyone, Jim, Jay. Maybe just for you on the -- just talking about -- you've talked a lot about MSC's production ramp that you're going to have over the next couple of years. Just how does this all tie in with the collaborative agreements you got with Ryan Mattel now, PAC-3 production opening up in Poland and I think Jim also mentioned Spain, an agreement there.

Just can you give us an update on PAC-3, what the growth kind of expansion looks like now and same, I guess, on some high HIMARS and JASSM, what some of those growth rates look like? Thanks.

Jesus Malave, Jr. -- *Chief Financial Officer*

Sure. A lot of these agreements enable -- they're part of in-country requirements for industrial cooperation. You mentioned Poland, you mentioned Germany, also

Australia. And those are enablers for us to build up this backlog and drive this demand.

On the PAC-3 specifically, we expect to get to $550 million in 2025, and then to $650 million by 2027. And so all of these orders and these partnerships that we're signing up, while all enablers to us to be able produce and deliver at those rates. And it's not just PAC-3. We've talked about GMLRS going from 10,000 to 14,000.

We've talked about Javelin going from 2000 to about 4,000. We've talked JASSM and LRASM going from about 700 a year to 1,100 a year, so all of these orders that we're seeing, all these customer engagements that we have both domestic and international are all enablers to drive to these rates that we're building to. And so what they do is fill in the bucket to bring us to that backlog that's necessary for us to generate those sales. And we're on track to that.

Operator

The next question comes from the line of Jason Gursky from Citi Research. Please go ahead.

Jason Gursky -- *Analyst*

Yeah. Good morning, everybody. Jim, I wanted to just throw a big picture one at you, and maybe have you kind of wrap all of this together and kind of what you're seeing both in the near and in the long term? And maybe just get your sense of maybe with a few more quarters here of hindsight, some of the lessons learned from the conflict in Ukraine. What you at Lockheed have learned from that whether you're investing in any new areas as a result of that? And kind of the feedback loop that you're getting from your customer both here in the United States, as well some of our allied nations as well.

Are we seeing a development of a new set of requirements and investment areas kind of where are you spending and how are you going about doing it? Just a big picture, here we are middle of 2024, what have we learned from Ukraine? And what are we doing?

James D. Taiclet, Jr. -- *Chair, President, and Chief Executive Officer*

So, Jason, I would say that there's a wide range of lessons from the Ukraine conflict unfortunately, as it is, but there's learning from it. One is that traditional system, if you will, like Javelin, at the initial invasion, made a significant contribution to the initial defense of Ukraine because it was a classic armor attack and armor-supported infantry attack, meaning there were armored vehicles that were spearheading the drive to Kiev. And when those vehicles got out in front of their support system that the Javelin, for example, made a tremendous difference in stopping that attack short, right? So you have a traditional system that was designed for land warfare -- traditional land warfare, if you will, that was highly effective. So we did learn from that.

Now, there's jamming both ways, electronic warfare, there's cyber and it's like I tell my teams like your high school wrestling coach that for every move, there's a counter move. So if you jam GPS, we tweak the system, either the satellite or the receiver, or have an alternative form of navigation or targeting, and we react to that. So on one hand, traditional systems are still effective. On the other hand, you have to be able to adapt quickly.

I'd say that was the main lesson there. Another one, similar situation, PAC-3, again, decades in service. And now there's a hypersonic missile threat from Russia, which was launched on a number of occasions. I think all those occasions, none of those missiles were successfully reaching their target because the PAC-3 was modified to be able to address the hypersonic missile threat.

And then we'll go to the kind of the other side of the issue, which is, OK, drones became a more important element of land warfare than it had been before, -- and in sea warfare actually, Ukrainians to sea -- autonomous sea vehicles to significant extent and success and also drones and unmanned aerial vehicles, too. So this is not the first time. Those kinds of systems have been used in prior conflicts, including in the Middle East and the counterterrorism wars, if you will. But the Ukrainians took it to a new level, literally sinking capital shifts with unmanned aerial systems.

So there are lessons there, too. That's something our company is quite involved with a lot of is classified, whether it's kinetic or surveillance, unmanned aerial systems, but we're learning from those too. So we work with drones as smallest ones that a marine can unpack from a backpack and launch by hand to aircraft size drones, if you will. So we're involved in that game, and we did take the lessons from the Ukraine war.

And that's traditional systems are still essential at bulk and scale. And secondly, they have to be much more adaptable than they ever had to be before. And that kind of supports our digital technology effort and campaign to say, let's use those best digital technologies to make those legacy systems better and better and all the time not wait for a conflict to force us to do that.

Maria Ricciardone -- *Vice President, Treasurer, and Investor Relations*

Great. Hey, Lois, I think we've come to the top of the hour. So I'll turn it back over to Jim for some final thoughts.

James D. Taiclet, Jr. -- *Chair, President, and Chief Executive Officer*

Thanks, Maria. So before we close, I'd like to thank our Lockheed Martin team whose dedicated efforts to advance our customers' missions and propelled our solid results this quarter, as you heard from Jay. Our capabilities are recognized around the world as the best in defense tech. And that is thanks to our to our employees' hard work, dedication, and commitment to continued innovation.

With 21st-century security technologies, I just described our robust backlog and focus on transforming our operations internal digital transformation program. Our company has a strong foundation for growth for years to come. So I look forward to speaking with you again on our next call in October, and Lois that concludes our call for today.

Operator

[Operator signoff]

Duration: 0 minutes

Call participants:

Maria Ricciardone -- *Vice President, Treasurer, and Investor Relations*

James D. Taiclet, Jr. -- *Chair, President, and Chief Executive Officer*

Jesus Malave, Jr. -- *Chief Financial Officer*

Jay Malave -- *Chief Financial Officer*

Kristine T. Liwag -- *Analyst*

Jim Taiclet -- *Chair, President, and Chief Executive Officer*

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Peter Skibitski -- *Analyst*

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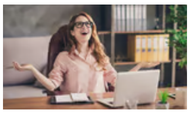

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