Lockheed Martin (LMT) Q4 2024 Earnings Call Transcript

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LMT earnings call for the period ending December 31, 2024.

Lockheed Martin (LMT 4.30%)

Q4 2024 Earnings Call

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IMAGE SOURCE: THE MOTLEY FOOL.

Contents:

Prepared Remarks:

Operator

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

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

Thank you, Sarah, and good morning, everyone. I'd like to welcome everyone to our fourth quarter and full-year 2024 earnings conference call. Joining me today on the call are Jim Taiclet, our chairman, president, and chief executive officer; and Jay Malave, our chief 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 law.

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 have 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 fourth quarter and full-year 2024 earnings call. As you saw in the press release this morning, our return to growth strategy that we implemented three years ago is well on its way and remains on a strong trajectory. In 2024, sales grew 5% year over year, and our backlog of $176 billion reached yet another record, demonstrating the enduring global demand for our superior, scalable, and reliable products and systems.

Each and every one of our four business areas saw backlog growth and ended the year with a book-to-bill ratio of greater than 1. We fully expect these positive trends to continue in our 2025 outlook with mid-single-digit growth in sales, segment operating profit returning to 11%, and double-digit growth in free cash flow per share. Jay and Maria will cover the financials in more detail, but I'd like to briefly comment on the earnings impact in the fourth quarter of two classified programs at

MFC and aeronautics, respectively. Recording charges in Q4 on these two programs enabled us to derisk the financial profile of both these critical national security programs going forward as we move into their next phases.

While these particular contracts were struck a number of years ago, there are no longer any must-win competitions. Under today's Lockheed Martinwide bid process, every proposal adheres to a stringent, risk-adjusted ROI regime. This process is designed to compete aggressively for key opportunities while also being very committed to achieving positive results, both in the short and long term for our shareholders. At the same time, we are committed to ongoing investment in the business to further enhance our company's growth trajectory, having successfully executed our return to growth initiative over the past few years.

In 2024, we invested $3.3 billion in research and development and capital to support advanced scalable technology solutions for our customers. Equally important, looking forward, our investments to enhance the attractiveness and performance of our key programs and initiatives, such as America's preeminent fifth-generation fighter, the F-35; and our internal digital transformation of 1LMX, are expected to grow. Our financial focus remains on free cash flow and free cash flow per share. Our company continued to deploy significant free cash flow in 2024, and we've returned greater than 100% of that free cash flow to you, the shareholders.

In addition to our consistent and healthy dividend, we maintained a robust share repurchase program with $3.7 billion of shares repurchased in 2024. Turning to the F-35. We delivered 62 aircraft in the quarter, bringing our total deliveries for 2024 to 110, the high end of our expected range. These deliveries included aircraft that were previously parked and new jets that rolled off the production line.

We continue to expect deliveries will exceed the production rate over the next few years and estimate 170 to 190 F-35 aircraft deliveries in 2025. TR-3 capabilities continue to progress in flight testing. We completed qualification testing on a set of key TR-3 capabilities in 2024, and we're making solid progress on system performance and remaining TR-3 deliverables. We expect to release additional capability this year with further upgrades to follow.

In addition, the undefinitized contract for Lot 18 F-35 production was awarded in December, bringing our backlog to 408 aircraft. We expect this contract will be definitized during the first half of 2025. We welcomed our 20th global customer, Romania, into the F-35 enterprise in November with its letter of offer and acceptance to procure 32 aircraft. The Romanian Air Force's F35 will integrate with their existing F-16 fleets, as well as other allied F-35s, highlighting the importance of the superior capabilities of this aircraft.

Moreover, the F-35 seamless interoperability, using our 5G.MIL architecture will be crucial in establishing and maintaining command of the air, especially in the Indo-Pacific European and Middle Eastern theaters. Lockheed Martin's system of integration expertise across land, air, sea, space, and cyber are essential to continually improving many important national security missions, such as protection from air and missile attacks. In this example, our Defense of Guam flight experimentation mission in December successfully demonstrated the integration of multiple Lockheed Martin and other OEM products into a single combined weapon system. Our Aegis Guam system was successful in acquiring and tracking targets using our TPY-6 radar, planning and conducting the missile engagement using our Aegis Combat System, then we fired the interceptor from one of our vertical launching systems and ultimately destroyed the incoming weapon.

Equally important was the accelerated pace from contract award to successful completion of this flight test mission in under two years and was a direct result of leveraging prior investments in all these proven technologies. Building on our production-ready Air Launch Rapid Response Weapon, or ARRW, America's hypersonics technology made another important milestone in the development of one of our most important and advanced weapon systems in December. The U.S. Army and U.S.

Navy completed a successful end-to-end flight test of the common hypersonic All Up Round, the first live-fire event for the long-range hypersonic weapons system. I'd like to shift gears now to current discourse about the defense industry landscape. Much has been said about defense primes, emerging start-ups, traditional and nontraditional companies. I see us all working together, and I think that it's industry's role to help marshal the talent and expertise in our country to provide the best possible deterrent capabilities with both physical products, such as ships, aircraft, and satellites, as well as digital advanced technologies.

We need to access the best talent, financial resources, and technologies from both the aerospace and defense and commercial sectors to get ahead and stay ahead. To that end, on the commercial front, I've long been an advocate of deepening partnerships across industries, and we have done so with companies such as NVIDIA for artificial intelligence; Meta, and IBM for large language models to more efficiently generate code, analyze data, and enhance business processes; Verizon for 5G networks; Microsoft for classified cloud modeling and simulation; and Intel and GlobalFoundries for advanced military hardened chips. We're also investing heavily on internal development autonomy, AI, and other enabling digital technologies to provide the best solutions for our customers. Skunk Works continues to drive the cutting-edge, theater-level security solutions.

In real-time live flight demonstrations, we had an F-35 flying from our facility in North Fort Worth, Texas, sharing classified data by a Skunk Works open system gateway through a commercial satellite communications and all the way over into a Royal Air Force lab in Farnborough U.K., where it was integrated into their command and control system. This achievement marks a significant step toward a future integrated defense, enhancing our F-35 interoperability in real time with an allied C2 system using our 5G.MIL architecture. In another first, our Lockheed Martin Skunk Works team, along with the U.S. Navy and General Atomics, completed a live controlled flight demonstration of an uncrewed system by the Unmanned Carrier Aviation Mission Control Station, which was powered by our autonomy platform.

This demonstration is a path finder that helps advance the complex technology necessary to enable human machine teaming as envisioned for autonomous systems. We're doing it right now. Turning to the budget. The current continuing resolution funds U.S.

government operations through March. We look forward to working with the returning administration to continue pursuing a more agile and streamlined acquisition process that encourages speed, technology innovation, and broader participation. We see DOGE as an opportunity to make great progress in all these areas, and we will continue to share ideas and do our part to support efforts to eliminate unnecessary regulatory hurdles while working to increase efficiency in our own internal operations through our 1LMX digital transformation. Now I'll turn it over to Jay.

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

Thanks, Jim, and good morning, everyone. Today, I'll provide an overview of our consolidated financial results for the fourth quarter and full year then hand off to Maria, who will cover business area financials, and I'll come back at the end to discuss our initial 2025 outlook. 2024 was a solid year. Our growth strategies are paying off with 5% top-line growth while also growing backlog 10% to $176 billion, another year-end record.

Our balanced portfolio enabled us to generate solid free cash flow and meet our deployment commitments exceeding 100%. Finally, we took prudent derisking actions on key programs that paved the way for a solid outlook in 2025 and beyond. Before I get into the results in more detail, I'll walk you through these derisking actions. Chart 4 provides two different reconciliations that detail the full impact of these items on our full-year results and their partial impact to our prior expectations.

We've also included a fourth quarter version of the same chart in the appendix on Slide 20. For purposes of understanding the total impact on our full-year results, I'll direct your attention to the middle section of the chart. We recorded net charges of $1.8 billion as follows: $1.4 billion related to the remaining expected future losses on the MFC classified program and $555 million associated with the aeronautics classified program with these amounts partially offset by $155 million benefit associated with our C5 claim resolution. Moving over to the right side of the chart.

You may recall that our last outlook in October had assumed some of these net charges, so let me walk you through that as well. Relative to our prior outlook, we recorded $1.4 billion of unplanned net charges, consisting of $410 million for the aeronautics classified program, $1.1 billion from the MFC classified program with these amounts partially offset by $70 million of unplanned benefit from the C5 claim resolution. Both reconciliations provide adjusted results to exclude the impact of these items for comparison purposes. For the remainder of my prepared remarks, I will refer to the reported and adjusted amounts as shown on the left side of the chart, unless otherwise noted.

OK. Moving to Chart 5 with fourth quarter results. Sales of $18.6 billion were down slightly year over year. Sales in the quarter were unfavorably impacted by having one fewer week in Q4 '24 compared to Q4 of '23, partially offset by the F-35 Lot 18 deferred revenue carryover from the third quarter.

Segment operating profit, segment margins, and earnings per share were all adversely impacted by the classified program charges at aeronautics and missiles and fire control. On an adjusted basis, segment operating profit would have grown 5% year over year to $2.1 billion, resulting in segment margins of 11.1%. Shifting to new business. We recorded over $29 billion of orders in the fourth quarter for a book-to-bill ratio of approximately 1.6.

Aeronautics led the way with almost $20 billion in orders, driven by the F-35 Lot 18 and fiscal-year '25 air vehicle sustainment contract awards. Both contracts will help secure the wide-reaching F-35 U.S. production enterprise and ensure America's military is equipped with the most advanced fighter aircraft in the world. Free cash flow was $440 million in the quarter, including $990 million of pension prefunding to extinguish the 2025 required contributions.

Continuing with capital deployment, we further advanced strategic and technical and operational capabilities by investing over $1.1 billion in the quarter toward independent research and development and capital expenditure projects, bringing full-year internal investment to $3.3 billion. We continue to provide an unmatched combination of new technology advancement that can be also fielded with speed, so investing to deliver critical capabilities while maintaining our commitment to shareholders by returning $1.8 billion of free cash flow via share repurchases and dividends. Turning to Chart 6 and our full-year 2024 results. Sales of $71 billion grew 5%, driven by improved backlog conversion, reflecting stronger throughput across the entire value chain.

Similar to the fourth quarter, segment operating profit, segment margins, and earnings per share were impacted by the net program charges on Slide 4. On an adjusted basis, segment operating profit grew 7% year over year, and adjusted segment margins were 11.1%. Book for the book to bill for the year was greater than 1 and the third consecutive year we've increased backlog. We generated $5.3 billion of free cash flow, including the pension prefunding.

And finally, our consistent capital deployment continued in 2024 as we returned $6.8 billion to shareholders through repurchases and dividends. Now I'll turn it over to Maria to discuss business area results.

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

Thanks, Jay. Today, I'll discuss fourth quarter and full-year results for the business areas. As Jay mentioned, you'll notice that we've included both reported GAAP and adjusted results for each business area in order to provide meaningful comparisons and a more realistic expectation of recurring operational performance. Starting with aeronautics on Chart 7.

Fourth quarter sales at aero increased 5% year over year, primarily driven by higher F-35 volume on production and sustainment contracts due to contract awards in the quarter, including the awards for the Lot 18 undefinitized contract action and air vehicle sustainment contract. Partially offsetting this was lower volume at Skunk

Works, driven by the unfavorable sales impact associated with the classified program charge. Adjusting for the impacts of the classified program charge and the C5 contract resolution, the adjusted sales growth at ARRW was approximately 7% year over year in Q4 2024. Both reported and adjusted sales in the fourth quarter benefited from $700 million of F-35 sales deferred from the third quarter.

Segment operating profit decreased 43% compared to Q4 2023. Lower profit booking rate adjustments due to the $410 million classified program charge in the quarter were partially offset by higher sales volume and the benefit related to the C5 claim resolution. On an adjusted basis, operating profit year over year in the quarter increased slightly. For the full year, sales increased 4% and driven by higher volume across the F-35 program and the production ramp on the F-16 program, partially offset by lower volume at Skunk Works due to the sales impact related to the classified program charge.

Full-year segment operating profit decreased 11%, driven by the same items we saw in the fourth quarter. Lower profit rate adjustments, partially offset by sales volume and the C5 claim resolution benefit. On an adjusted basis, aeronautics full-year operating profit grew by 3%, equating to 10.2% margin for the year. Turning to missiles and fire control on Chart 8.

MFC sales increased 8% year over year, driven by production ramps on Joint Air-to-Surface Standoff Missile, JASSM; Long-Range Anti-Ship Missile, LRASM; Guided Multiple Launch Rocket System, GMLRS; and PAC-3. Normalizing for the extra week in the fourth quarter of 2023, MFC sales grew 16% year over year. Segment operating profit decreased significantly year over year in the quarter due to lower profit booking rate adjustments, driven by the recognition of reach-forward losses on the classified program. Adjusting for that item, segment margins were a strong 14.8% in the quarter.

For the full year, MFC sales increased double digits, up 13%, again, due to production ramps on GMLRS, LRASM, JASSM, and PAC-3 programs. Full-year segment operating profit declined $1.1 billion year over year due to $1.4 billion of classified program charges, which were partially offset by higher volume from the production ramps. Excluding the classified program charges, MFC's segment operating margin for the full year was a solid 14.4%. Shifting to rotary and mission systems on Chart 9.

Sales decreased 10% in the quarter to approximately $4.3 billion, primarily driven by lower volume on Seahawk, CRH, Aegis, and various C6 ISR programs. Normalizing for the week difference in Q4 2023, RMS sales were down 3% year over year in the quarter. Similar to sales, operating profit was down 11% year over year due to lower profit booking rate adjustments and sales volume, partially offset by favorable contract mix. For the full year, sales increased 6% at RMS, primarily driven by higher volume on the Canadian surface combatant and laser programs within the integrated warfare systems and sensors business, as well as various C6 ISR programs and the CH-53K ramp at Sikorsky.

Operating profit was up 3% for the year due to the higher sales volume and favorable contract mix, partially offset by lower profit booking rate adjustments. Finally, with space on Chart 10. Sales decreased 13% year over year in the fourth quarter. The reduction was driven by lower volume on Next-Gen OPIR, Orion, and classified, primarily due to program life cycles.

Normalized for the number of weeks in the quarter year over year, sales were down 6%. Operating profit decreased 8% compared to Q4 2023, driven by lower volume and lower profit booking rate adjustments, partially offset by higher equity earnings from the United Launch Alliance. Turning to the full year. Sales decreased slightly, driven by lower volume on the same programs as in the fourth quarter, partially offset by higher volume on the fleet ballistic missile and reentry program.

Meanwhile, operating profit increased 6% in 2024 due to favorable contract mix and higher ULA equity earnings, partially offset by lower profit booking rate adjustments. I'd like to note the photo on Page 10. In December, Lockheed Martin supported the successful launch of the GPS 3 space vehicle 7, which we designed and built. This accelerated launch required complex integration and was the first to demonstrate operational agility for critical national security missions.

With that, I will turn it back over to Jay to wrap up our prepared remarks.

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

All right. Thanks, Maria. Turning to Chart 11 and our forward expectations. Our outlook for 2025 has improved since October, along with our rising value chain performance expectations, in addition to the benefit from the derisking actions we took in 2024.

We anticipate sales growth of 4% to 5% on top of the 5% we delivered in 2024. We expect MFC to again lead the way with 8% growth at the midpoint as we continue to ramp production across several programs to support the strong demand for our combat-proven munitions and integrated air and missile defense systems. As previously discussed, operating margins returned to 11% and free cash flow grows 9% at the midpoint from 2024 and adjusted results, setting up double-digit growth in free cash flow per share in spite of non-CAS/FAS pension headwind lowering EPS. I'll step through segment operating profit and EPS bridges in more detail on the following charts.

Chart 12 bridges the 2024 reported segment operating profit of $6.1 billion to the 2025 guidance midpoint of $8.15 billion. After accounting for the 2024 net charges, we expect operating profit growth from the adjusted 2024 position. The growth is primarily due to the volume drop-through and partially offset by other items, mainly lower expected net profit rate adjustments. Importantly, segment margins are expected to return to 11% in 2025 earlier than planned.

Next, on Chart 13, we have a similar walk for earnings per share. Here, we expect EPS to decline slightly from a 2024 adjusted position, mainly due to nonoperational items, notably the FAS/CAS pension adjustment, as well as higher interest expense. Bringing it all together, we expect solid sales growth in 2025 off the higher 2024 base, operating margins at the 11% target, and solid cash flow generation that enables consistent shareholder returns. So in summary on Chart 14.

In 2024, we delivered stronger top-line growth than initially expected, reflecting an improving operating cadence. We also expanded our backlog to a new record, demonstrating the strength of our unmatched capability to deliver security solutions at speed while increasing investment to expand this capability, and we prudently derisked programs, all the while dependently generating free cash flow and deploying it as committed. Taken together, these actions give us confidence to deliver a strong financial outlook for 2025. At the same time, we will continue to propel this industry forward with innovative solutions that integrate the best that commercial and military industries can offer.

And of course, we remain focused on operational execution to deliver on our commitments and create long-term value for our customers and shareholders. With that, Sarah, let's open up the call for Q&A.

Questions & Answers:

Operator

Thank you. [Operator instructions] Your first question comes from the line of Seth Seifman from J.P. Morgan. Your line is open.

Seth Seifman -- *Analyst*

Thanks very much, and good morning, everyone.

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

Good morning, Seth.

Seth Seifman -- *Analyst*

Hey, good morning. I wanted to ask, Jay, emphasized kind of the derisking nature of the charges in Q4. I know maybe it's difficult to discuss because it's classified. But within aeronautics, all of the filing language has sort of emphasized continued risk there.

Should we think that within -- following this charge, the potential for future charges there has really come down considerably? And is there anything you can say about where we might be in the life cycle of that program and when it might be able to provide some positive returns? And then thinking maybe that the answer to there might have to be a little bit circumspect, if you could just comment on the multiyear targets that you gave on the last call and how to think about those now.

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

OK. Thanks, Seth. There's about 16 questions in that one question, but I'll take a shot at all of them. Just as far as the risk, I would say we significantly reduced the risk.

I can't really get into the life cycle of the program given the classified nature of it, but let me walk you through why I believe that we've significantly reduced the risk. As you know, we had realized this risk earlier in the year, causing us to perform a more comprehensive review of current performance versus our key assumptions included in the estimate to complete. We evaluated the risk and opportunities and made the determination that a cost reset was warranted. The amount route that we recorded in the quarter is the most conservative assessment we've made to date.

We've also made a number of process changes. Aeronautics, along with our corporate staff, have implemented a more continuous monitoring process – a process of the progress of this program in terms of technical milestones and added technical resources from the outside the program. This will enable both teams to work together to institute support measures as needed faster than before. We've also added technical resources and experts with experience in the risk areas to help bolster the team and mitigate risks as they arise.

We've added automated testing procedures as well to accelerate test results and issue resolution should they occur. So all those things taken together give us confidence that we have significantly derisked this program and significantly reduced the risk of future charges on this. As far as maybe the multiyear outlook, you look at 2025, and certainly, the 2025 outlook is better than what we had projected in October. If you recall, we had said our baseline was low single digit with an opportunity to get to a mid-single digit.

Here, we believe the opportunity was realized for 2025 which gave us confidence to increase our growth outlook to 4% to 5%, and that's the same type of process that we'll continue to look at in '26 and beyond. And again, it's based on our ability to really drive throughput through the entire value chain. As I mentioned before in my prepared remarks that we continue to have rising expectations there and rising confidence that not only our supply chain but our internal operations can move at a quicker pace, enabling the unlocking of this revenue growth, so our confidence is growing there.

Operator

The next question comes from Rob Stallard with Vertical Research Partners. Your line is open.

Robert Stallard -- *Analyst*

Thanks very much. Good morning.

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

Good morning.

Robert Stallard -- *Analyst*

A question for Jim. At the same time as you're taking these charges on these classified programs, it looks like the new administration and the Department of Defense is actually getting more pro fixed-price contracts in commercial terms. Are you worried that the defense industry could be taking on more risk and opening itself up for more charges in the future?

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

Not necessarily, Rob, because we're going to apply this disciplined bid process to fixed-price and cost-plus contracts. And if the proportion is moving potentially toward fixed price, we're going to use the same discipline. And there's a trend in this industry to be much more deliberate about how each company bids. Each company has its own strategy.

Ours is something I brought over from my last business experience, which is adjusted -- risk-adjusted return on investment is the key criteria and be honest about the risk upfront and price them in. And if that price doesn't meet the competition, so be it. We'll move on to other things. So I'm not concerned about that.

As I said, I look at DOGE as an opportunity because as far back as 2021, I've been advocating for a systemic change in the way that the defense enterprise operates, and that's meaning Congress, executive branch, Pentagon, aerospace and defense industry, commercial tech start-ups. We need to expand our ability to the country to get everybody involved, and I welcome DOGE's effort and the administration's effort to reduce the bureaucracy, limit the administrative burdens that the Pentagon now puts on all companies, big and small, that want to work with it. So again, I look at all of this as an opportunity. And if it moves a bit more toward fixed price proportions, so be it.

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

Rob, the other thing I would say is we've seen really, to be honest, more over the last probably year to 18 months, more of a contracting regime that's more commensurate with the risk associated with the program. So those that have lower technical maturity, higher risk, the customer has actually been much more receptive and cognizant that those probably are not going to be best delivered under a fixed price type of contracting regime. And so you may be hearing words on the one end, but I think there has been a recognition more to make sure that the risk profile is commensurate with the right level of contracting, and that's shared both by the customer and as well as industry. And so there just has been, I think, a different approach.

We'll see. You've got a change in administration and where it goes forward, but I would say there's been a recognition over the last 12 months that fixed price contracts for immature technology really doesn't help anyone.

Operator

The next question comes from Rich Safran of Seaport Research Partners. Your line is open.

Richard Safran -- *Analyst*

Thanks, Jim. Good morning. What I'd like to ask is, starting with your 2025 guide for 8% growth, I'd like to know if you could give us maybe a long-term look at MFC in terms of growth and margins and what the potential for the business is? Just kind of wondering you have the GD rocket motor deal and how that factors into your growth and margin outlook given the volume limitations you've had thus far. Thanks.

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

Well, for MFC, for 2025, it's really more of the same. We continue to see growth on programs like GMLRS, HIMARS, PAC-3, JASSM, and LRASM, and so many of the same growth factors and drivers in 2024 are also the growth drivers in 2025. That demand continues. We have projected orders growth in 2025, things like a multiyear definitization on JASSM and LRASM, which is a pretty sizable multiyear contract.

And so the demand cycle there, both domestically and international, was quite strong. And as we've said before, that will be the growth driver for Lockheed Martin for years to come beyond 2025. And so again, when you couple the backlog with the ongoing demand, we feel pretty solid again in these programs. Just there's a solid back pinning of the underlying demand for those.

On the margins, we've talked about when you strip out the impact of the classified program, we've talked about 14%. If you look at the midpoint of our guide in that ballpark, we're right around 14%, not necessarily as high as Maria reported on an adjusted basis for 2024. But that's because, right now, we're expecting some lower net profit adjustments, but their underlying margins are generally in line with what our longer-term expectations are, and that's the way you should think about MFC, around 14%.

Operator

The next question comes from Ken Herbert of RBC Capital Markets. Your line is open.

Kenneth Herbert -- *Analyst*

Yeah. Hi. Good morning.

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

Morning.

Kenneth Herbert -- *Analyst*

Jay, in the past, you've talked about working capital and specifically the opportunity there to improve the free cash flow. Can you provide a little bit more on what's implied in the '25 guide from working capital improvement? And has anything structurally changed now as you look at the portfolio and the opportunity as you've talked about taking days out and the ability to eventually or continue to drive toward sort of pre-pandemic levels over time?

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

Sure. You look at -- I'll start with maybe 2024. We had a good year in 2024 in spite of some of the headwinds that we faced. We reduced our working capital days by a couple, and we're in the mid-30s as far as cash conversion cycle.

For our outlook in 2025, what's implied in there is about one day, which essentially offsets the growth that we're going to see from -- we would otherwise see in working capital. So what we're trying to do here is just prevent it from being a use of cash and have it be neutral. The opportunity set, obviously, would be to drive beyond one day. And there's still opportunity that I talked about before, particularly in our contract assets, our unbilled receivable.

There's some opportunity there as we work through on the F-35, both in production, as well as sustainment, but there's really opportunities across the portfolio. Sikorsky has a number of opportunities there on their programs, as well as even the segments, space and MFC, those are outstanding working capital businesses on a stand-alone basis. But even so, there's opportunity in the contract assets there. So I would expect in the years to come that we still have opportunity to continue to drive asset productivity there, and that's going to be part of our formula going forward as it was in '24 and our outlook for '25.

Operator

The next question comes from Gavin Parsons with UBS. Your line is open.

Gavin Parsons -- *Analyst*

Hey, thanks. Good morning.

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

Good morning.

Gavin Parsons -- *Analyst*

Could you just dig in a little further on the free cash flow bridges? The EBIT and EPS bridges were super helpful in the deck. But just given a lot of moving pieces in cash flow, like the F-35 inventory unwind pension contribution recovery, Lot 18, cash timing. Maybe I missed that one. But if we could just kind of do a bridge walk on cash flow, that would be great.

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

Yes. If you just start from this year, adjusted cash flow of $6.1 billion, so adjusted for the pension contribution in 2024. As we mentioned, we expected anywhere around close to $1 billion of benefit on F-35 with the delivery of -- with higher deliveries, as well as progress on the withholds. We also, though, as you remember, in 2024, we got the benefit of significant international advances to the tune of $600 million.

So partially offsetting that is -- it's the net impact of those two things, about $400 million in that ballpark. We do expect a benefit from taxes with lower R&D capitalization as that's coming down. We expect a little bit of benefit from, I'll call it, cash-based net income. All that taken together takes us from $6.1 billion to the $6.7 billion midpoint.

So those are the key drivers of free cash flow for 2025.

Operator

The next question comes from Scott Deuschle of Deutsche Bank. Your line is open.

Scott Deuschle -- *Analyst*

Hey. Thanks, Jay. It looks like if you're guiding -- looks like you're guiding aeronautics margins down about 20 basis points year over year in '25 if I add back those unplanned charges to the 2024 base. So can you talk a bit about what drives that underlying margin decline, particularly given that you are on these newer contracts for F-35?

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

Yes. So for F-35, we do have -- I'm sorry, for aeronautics in total, right now, the outlook for the margins does assume lower net profit adjustments. And that's on, call it, an apples-to-apples basis. So excluding the impact of the $555 million in the C5 adjustment in 2024, profit adjustments there are declining.

There is a mix benefit. But right now, the net profit adjustments offset that, and that's what drives the margins down from 10.2 to around 10. We also have classified growth, which is just a mix headwind there, but that's -- we've got some benefits from F-16 margins as well. But bottom line, again, it comes back to the net profit adjustments being lower.

Operator

The next question comes from Matt Akers with Wells Fargo. Your line is open.

Matt Akers -- *Analyst*

Yes. Hey, guys. Good morning. Thanks for the question.

I guess a couple on F-35. You talked a little bit about the progress toward Tech Refresh 3. What exactly is left to get kind of the final withhold? How big is that? And are you assuming to get that in -- within 2025? And then I wonder if you could touch on Lot 19 and kind of how the discussions are going there.

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

Well, we -- so on the TR-3 capability, we continue to make excellent progress there. There's a number of things that we still have to complete. Submission system integration work, as well as improving system stability overall, we expect that will continue throughout the year. We'll meet -- we expect to meet some milestones this year.

We're targeting as much as possible this year. But I think for purposes of financial modeling, we would expect this to bleed into 2026. Ultimately, the declaration of full combat capability is one that is left with our customer, and so we'll be coordinating with them and working with them on that. But what I can tell you is that we're pleased with the progress we've made thus far, and the team is just -- is working at a pretty good pace here with our supplier partners on improving, a, the emission system capability and as well as improving overall system stability.

The second part of the question was Lot 19. So that has been negotiated really in parallel with the Lot 18 negotiation. Just for clarity, Lot 18 is under undefinitized contract actions. So we still have to definitize that.

And as Jim mentioned, we expect that to be done in the first half of this year. And then shortly thereafter in the second half of this year, we would also expect to close out on the Lot 19 contract, which would be an order in the range of about $10 billion.

Operator

The next question comes from Myles Walton of Wolfe Research. Your line is open.

Myles Walton -- *Analyst*

Thanks. Good morning. I was curious on the charges that were unplanned, Jay. How should we think about the cash effect of those and obviously the MFC part of that unplanned you were just planning in the future.

So I'm going to guess there's nothing really to think about there. But on the aero side, the $400 million of cash charges taken in the quarter, is that $400 million headwind being absorbed mostly in 2025? And then as we look to '26, do you still have the pension funding requirement coming back about $1 billion?

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

Yes. The -- just starting with the aero classified program. That will be a -- certainly a cash flow drag over the next few years. It's not all born in 2025, but it is something that we expect over the next two to three years that we will have to liquidate that from a cash perspective.

As far as pension in 2026, we talked about ongoing cash contribution requirements. The formula to deal with that is similar to what we saw here and we've been talking about. We had the prior discussion here and one of the questions related to working capital. We're going to continue to see what we can do to drive working capital down, improve our asset productivity to offset as much as possible on the pension.

And then as you know, we've got a very strong balance sheet that gives us a lot of optionality and flexibility. So we expect to continue to deal with pension with the options that we have before us.

Operator

The next question comes from Gautam Khanna with TD Cowen. Your line is open.

Gautam Khanna -- *Analyst*

Yes. Good morning. I was wondering at the MFC program that had the charge, is there an opportunity on that program as you scale it to improve the profitability dramatically? I'm just curious over the option period. I imagine demand is pretty strong for that product, and I don't know if the pricing may adjust favorably at some point.

If you could speak to that.

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

Again, it's a classified program, Gautam. So it's not really all that much, but I can tell you is outside of the fixed pricing related to this next phase, that the pricing would be open, and we would expect to return to reasonable type margins over that period of time outside of where we have the fixed committed pricing. I wouldn't expect it to bounce back to MFC-like margins at that point in time. There still would be kind of ramp-up that you got to deal with.

But certainly, the margin profile will get substantially better.

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

And we expect this to be a long-lived program based on the technology and the value to the U.S. government. The next Air Force pilot, I can assure you, this is something they will want.

Operator

Your next question comes from the line of Peter Arment with Baird. Your line is open.

Peter Arment -- *Analyst*

[Inaudible] opportunities to maybe still grow your backlog. Your backlog is at record levels. It's up 10% for the year, big drivers in MFC and space. But how are you thinking about the opportunities to grow backlog in '25 and any international kind of awards that you're -- kind of pursuits that you would highlight?

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

So, Peter, it's Jim. I'm going to start with the -- some of the public statements of the administration, which is reforming the Pentagon, and opportunity there is more long lead time orders, less fragility in the system. In addition to that, multiyear contracting, which has been so far limited to munitions. Makes sense in a lot of other places in the Pentagon budget.

So if some of those policy changes get implemented, you might see backlog for a company like ours accelerate due to multiyears and longer lead time preorders. Jay?

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

Yes. The line of sight, we do have a line of sight to growth again in 2025. I wouldn't say that it's 10%, but we certainly have some level of growth that we're expecting in 2025 on the backlog. I talked about the $10 billion order on the F-35 on Lot 19.

I talked also earlier about the JASSM/LRASM multiyear. That's in the range. That's multiple billions of dollars. There's others.

There's the international opportunities as well. Turkiye is on the F-16 aircraft. There's just a whole slew of opportunities. We also have just continued F-35 sustainment contract, which will also be multiple billions of dollars as well.

CH-53K. Lot 9 is another one we'll be negotiating this year, which is well above $1 billion, so there's still an excellent line of sight to continue to grow this backlog. But as you know, we're also focused on making sure that we can accelerate the speed of our throughput and drive that backlog conversion faster.

Operator

The next question comes from Pete Skibitski with Alembic Global. Your line is open.

Peter Skibitski -- *Analyst*

Hey. Good morning, guys. Jim or Jay, just a follow-up on MFC. As you guys think about what DOD is signaling to you in terms of the peak production volumes on the key munitions and MFC, do you guys need additional supplemental bills to kind of get to those levels and sustain those levels? Or do you already have kind of funding line of sight from the Ukraine supplemental and maybe what's in the '25 baseline budget, maybe the '26 baseline? I just wanted to get a sense of budget risk there in terms of what your peak rates are assuming.

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

Yes. I mean, it's really not dependent on additional supplementals. I mean, a lot of this is -- a lot of the capacity is going to be committed and/or contracted with our customer. We just -- and I'll run through a couple of programs.

We had always been under contract to get the 550 on the PAC-3 program at 2025. We initially self-funded the investment associated with getting ourselves to 650 on

PAC-3. We've recently received a contract award for incremental funding on that related to the facilitization. We are driving toward 14,000 on GMLRS.

We've been driving, as Jim has mentioned in the past, to 4,000 on Javelin, 96 on HIMARS. And again, the line of sight to those and the funding that's been allocated to those is quite strong, much of which is under contract already. So we view that as fairly low risk at the moment.

Operator

The next question comes from Doug Harned of Bernstein. Your line is open.

Douglas Harned -- *Analyst*

Good morning. Thank you. On F-35, and there's been some noise as the new administration has come in about the F-35. But if I put all of that aside, during the first Trump administration, in each of the budgets, F-35 volumes were cut, there seems to be a view that we didn't need as many.

Congress, of course, added some back. But when you look forward, you're looking at still a 156 per-year production rate for a while. How do you think about the interplay of budget decisions in the U.S. with what has been some very strong export demand? In other words, if we should see some reductions in quantities in the U.S., are you still very confident you're going to be able to continue with that 156 level?

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

Doug, it's Jim. I'll start off and say yes, I am confident of the 156, and I think it will come from strong demand from the U.S. government and from our international partners. And one reason for that is basically part of deterrence theory is that you have to have the capability to make the adversary reconsider an adverse action against you.

And China, based on open source reporting, has increased production of the J-20, which I don't believe just sort of personally that it's just equivalent to the F-35, but it is their fifth-generation airplane, to over 100 units a year. We're doing 156. We're ahead of them. I think if there was a dramatic change in even the U.S.

order book and production, that might be a signal that would be adverse to maintaining an effective deterrent to them. And similar with munitions, right? I mean, everybody's watch a Dirty Harry movie or Clint Eastwood movie knows when you run out of ammunition, you're highly, highly vulnerable, and that supports some of the conversation Jay was just having. So my view is that there are some very capable people coming into the administration. They understand deterrent theory.

The last thing, I think this president and administration would want us to create a period of vulnerability with any of our major adversaries in the next few years. So I feel really confident about F-35 production. And the other thing I'll add is that we can already control out of an F-35, up to eight autonomous drones. We've shown this to the secretary of the Air Force a few months ago.

It's publicly -- public knowledge. There's some classified things that we're doing in the same arena, if you will, to be able to drive manned, unmanned teaming of the F-35 and the F-22. And the reason we're starting with the F-35 is because of TR-3. TR-3 gives the F-35 the three things that you need for an effective node and the 5G Internet of Things system, which is what we're talking about.

Those three capabilities are data processing. With our core processor, it's about 10 times from the prior. It's data storage. We have a large storage -- a larger storage unit.

And a multipath connection back to the cloud as you define the cloud, ours is DoD classified. But those are the three technical elements you need to have to be able to drive 5G-level connectivity among nodes in a network like this. And that's what we have to build. F-35, and we're upgrading F-22 in the same way, we'll have at least one and often more orders of magnitude capability in those digital arenas than the fourth-generation fighter jets we have.

And so the capabilities alone that the F-35 can bring to an integrated fight with drones and manned aircraft is unique.

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

Doug, I'll just also add to just maybe one data point here is that the age of the existing fleet is beyond 25 years, and so that is necessitating a recapitalization with the F-35. And so there's a certain reality that is going to require the demand of the F-35 to bring the age of that existing fleet back down.

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

And then the last thing I'll say is that there's -- based on, again, open-source reporting. The experience of the Israeli Air Force against the Iranian air defense system, which they took out in one night with what they characterize as fifth-generation aircraft, and you can match up what's in their inventory, with no losses. That would clear the way for fourth-gen aircraft, drones to come in and devastate that country if the Israelis decided to do so. That's the kind of impact that the high-end platforms have, especially if you can network satellite imagery, autonomous vehicle, drone imagery, and a companion to control speed that no one else can muster.

You can have that kind of lopsided victory, and that's another reason I think that the F-35 is going to demonstrate its value here, through the Israel experience.

Operator

The next question comes from Michael Ciarmoli with Truist Securities. Your line is open.

Michael Ciarmoli -- *Analyst*

Hey. Good morning, guys. Thanks for taking the questions. Maybe Jim or Jay, give a little bit more color on supply chain.

I know the general update had been -- the demand signals were pointing to mid-single digit. Any changes with that under the new administration? And then just given the supply chain and the new administration, should we think about that multiyear kind of framework being now firmly in mid-single digits for both revenue and cash flow?

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

It's a good question. Let me just answer your question kind of supply chain operationally. We have seen improvement. We saw improvement certainly in 2024, and we're at levels where they have approached, and in certain cases, have exceeded what they were pre-COVID.

Having said that, there are still discrete issues that we're dealing with across the portfolio. I think MFC is a good example, have done an outstanding job of managing a number of supply chain issues, but yet, they still are there. And so that while we have a solid growth outlook there and a strong growth outlook there, they're still being paced to a certain extent. And that bodes across much of the portfolio.

So Sikorsky's another one. CH-53K has been hampered. And while we have seen improvement, it's still not to the level where we need to be operating at from a contractual standpoint. If we continue to see, though, what we have seen, then sure, I would feel a lot more confident in a multiyear outlook that is more in this 4% to 5% range like we're guiding for 2025.

I think that we need to just go through a little bit more of the passage of time as we go through midway through this year. We get a better outlook on how 2025 is shaping up and how that informs 2026. We'll be able to give you a clear view longer term. But at the moment, we're encouraged by what we're seeing.

And surely, we've seen it here in 2025, and we're starting to gain confidence, as I mentioned before, that it can continue in '26.

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

Sarah, let's take one more question. I think we're approaching the top of the hour. And then after this question, we'll hand off to Jim for closing comments. So one more question, please.

Operator

Thank you. The last question will come from Ron Epstein of Bank of America. Your line is open.

Ronald Epstein -- *Analyst*

Hey. Thanks, guys, for the question. Maybe just kind of like -- I got a two-parter. The first part is easy, I think, maybe.

When they discuss this iron dome over the U.S., isn't that NGI, the contract that you guys already won? Or am I thinking about that wrong? Because isn't that what NGI is?

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

Ron, Jim here. It will be an integral part of a more comprehensive solution to Homeland Defense, and what the administration has laid out is a defense of the homeland against some -- a multiple set of attack options for any adversary. One of them is, as you say, intercontinental ballistic missile attack. That is something that the NGI is specifically designed to accomplish, but then there's also hypersonic attack.

We have a hyper -- counter-hypersonic effort in this company knowing that we're going to need to be able to do that. And by the way, to do it, you're going to need AI, and you're going to need high-speed data transmissions, and you're going to have to have multi-centers and multi-domains to do it. So that's the second one. A third one is cruise missiles, right? We've shown that we -- for example, we can shoot down cruise missiles with lasers now, and that could be part of the solution.

And then maybe the lowest level adversary would be a cheap in-country UAV attack, a drone attack on a public place, or an Air Force base, or some other U.S.-located facility or asset. And that's another set of technologies, which is counter UAS. And we haven't heard back from this administration yet on this topic, but we offer the prior administration at the SecDef level to organize a national team on counter UAS because I think we have some pretty good technologies. We want to add a lot more from some mid and large companies that do have the relevant technologies as well.

So I might have ran you out of time on your second part of your first question, but that's what I think of when I consider what iron dome would have to look like.

Ronald Epstein -- *Analyst*

Got it. So it's a broader thing than just sort of -- just call it missile defense?

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

Yes. And there's a public statement by the U.S. government that outlines a lot.

Ronald Epstein -- *Analyst*

Yes. And if I can just squeak in one last one and then well, I know we got to go. How are you thinking about -- I mean, Denmark is an important F-35 international customer, and there's a lot of rhetoric in the press around the U.S. mining Greenland.

How do you think about that and mixing that up with them being an important customer and what message that might send to other customers?

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

Look, these are policy issues by the U.S. government completely out of our purview, so I'll just leave that there. The demand for the aircraft is we've talked about keeps building, especially in international customers. And really, that's all I should comment on a policy matter such as this.

All right. Thank you, Maria, for managing all the questions. Before we close, I want to thank the Lockheed Martin workforce for constantly pushing the boundaries of innovation, to help our country and our allies accomplish their missions and maintain our ability to provide a strong deterrent to armed conflict, and if we must, defeat any enemy that attack us. And therefore, we used to call that flight, fight, and win.

As we did in this first term, we look forward to a very productive working relationship with President Trump, his team, and the new Congress to strengthen our national defense. We share a commitment to achieving peace through strength, and we're focused on delivering the best mission-critical defense technology in the world and at the greatest value to the American taxpayer. So with that, we'll wrap up the call. Thank you, everybody, that joined today, and we'll see you in April on our first quarter call.

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*

Seth Seifman -- *Analyst*

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

Robert Stallard -- *Analyst*

Rob Stallard -- *Analyst*

Richard Safran -- *Analyst*

Kenneth Herbert -- *Analyst*

Ken Herbert -- *Analyst*

Gavin Parsons -- *Analyst*

Scott Deuschle -- *Analyst*

Matt Akers -- *Analyst*

Myles Walton -- *Analyst*

Gautam Khanna -- *Analyst*

Peter Arment -- *Analyst*

Peter Skibitski -- *Analyst*

Douglas Harned -- *Analyst*

Michael Ciarmoli -- *Analyst*

Ronald Epstein -- *Analyst*

Ron Epstein -- *Analyst*

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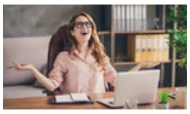
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