

Northrop Grumman (NOC) Q2 2024 Earnings Call Transcript

By [Motley Fool Transcribing](#) – Jul 25, 2024 at 2:15PM

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

Northrop Grumman (NOC 4.24%)

Q2 2024 Earnings Call

Jul 25, 2024, 9:00 a.m. ET

Contents:

- Prepared Remarks
- Questions and Answers
- Call Participants

Prepared Remarks:

Operator

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

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

Todd Ernst -- *Vice President, Investor Relations*



IMAGE SOURCE: THE MOTLEY FOOL.

Save 55%*

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

These risks and uncertainties may cause actual company results to differ materially. Today's call will include non-GAAP financial measures that are reconciled to our GAAP results in our earnings release. And also, we will refer to a presentation that is posted on our investor relations website. On the call today are Kathy Warden, our chair, CEO and president; and Dave Keffer, our CFO.

55% off Flash Sale!*

While uncertainty is on the rise, remember that volatility can also present great investing opportunities. Take advantage of our 55% off new member flash sale!

Since inception, Motley Fool Stock Advisor has historically beaten the S&P 500 by **731%** — a market-crushing outperformance compared to 146%!** New members can get a **55% discount*** AND Stock Advisor's top 10 stock recommendations. Don't miss out on this opportunity to invest in your future!

[Continue ›](#)

*\$89/year is a promotional price for new members only. 55% discount based on current list price of Stock Advisor of \$199/year.

Membership will renew annually at the then current list price. Offer expires on April 11, 2025 at 11:59 pm PST. **Stock Advisor

and S&P returns as of April 9, 2025.

Save 55%*

At this time, I'd like to turn the call over to Kathy. Kathy?

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

Thanks, Todd. Good morning, everyone. Thank you for joining us. As you saw from this morning's earnings release, we delivered excellent operating results again this quarter, building on momentum from the first quarter.

Our company's ability to respond to U.S. and international customer requirements with a wide range of advanced capabilities continues to drive strong growth, with sales up 7% in the quarter and 8% year-to-date. And our team's solid program performance, along with cost management discipline, led to operating income growth of 13% in the second quarter. The combined strength of our top and bottom line operating results was the primary driver of our 19% EPS growth.

And in addition, we delivered robust free cash flow, which is up over \$500 million compared to the first half of last year. Based on these strong first half results, and confidence in our team's ability to deliver on continued robust demand in the second half, we are increasing our 2024 revenue and EPS guidance. The breadth and depth of our portfolio is an important differentiator, particularly when coupled with the effectiveness of our strategy in aligning our resources to anticipate and deliver on our customers' needs. Given this, I'm going to take the next couple of minutes to provide important context on our portfolio.

When you step back and look at the key components of our business, you'll see that 85% of our sales come from a diverse collection of technology advanced capabilities, such as electronic communications, crude and uncrewed aircraft, special payloads, advanced weapons, command and control systems and other product areas which are critical to global security. The capabilities we provide often as a supplier are in the nation's most advanced space air, land, sea and undersea platforms. In the last several years, we've been selected through dozens of competitions to develop and build differentiating technologies that will provide an advantage to the U.S. and our allies through the 2030s.

The remaining 15% of our sales is comprised of two prime programs in support of the nation's strategic deterrent of course, that's Sentinel and B-21, with each generating a high single-digit percentage of our revenue today, and we expect that balance to continue for several years. With the recent realignment of our SCS division to our Defense Systems sector, we have four strong and differentiated segments that are more equal in size with each having multiple avenues for profitable growth. Our business is well aligned with the U.S. National Defense strategy.

And as I've outlined in recent years, we've won significant roles on long-term programs that address the threat environment of today and are expected to do so for the next several decades. In addition, we continue to expand exportable product offerings, and we are developing our international partner and supplier base to position us for the growing international markets. We have also invested to increase our capacity to deliver the quantities of rocket motors, armaments and air and missile defense capabilities needed by the U.S. and our allies to defend freedom and deter aggression around the globe.

Examples of this growth include the guided multiple launch rocket system or GMLRS, where our year-to-date revenue has grown by nearly 60%. Additionally, we were awarded over \$500 million in contract for ammunition that we will begin delivering in the third quarter. And we see additional demand for international ammunition opportunities in the coming quarters. Overall, the key takeaway is that the breadth of our portfolio, our alignment to the key priorities for the U.S.

and our allies and our role on each leg of the U.S. strategic triangle provides us visibility into avenues for our business to grow even if U.S. budget growth slows. And as we've discussed frequently over the last two years, we're not just focused on top growth, we're taking deliberate actions to enhance profitability through digital enablement, productivity, supplier management and cost efficiency.

As we look at the remainder of this year and next, we expect solid growth across our portfolio to continue, particularly in areas such as weapon systems, advanced

electronics and aeronautics. International sales are also progressing from our pipeline to our backlog and are expected to contribute to increased sales and profitability. Our outlook is supported by the national security spending environment. In the U.S., the fiscal year 2025 defense budget is moving through the appropriations process with recent markups by Congress.

We were pleased to see the Senate Armed Services Committee increase the FY '25 top line by \$25 billion, and we're encouraged by continued support for investment in defense. Northrop programs broadly and particularly the B-21 Sentinel in Colombia, which provide the basis for the U.S. strategic deterrent, continue to receive strong support, bolstering our view that we're well positioned in this such an environment.

Given the importance of the triad to the nation's deterrence, I'll provide an update on the two legs of the triad for which Northrop Grumman is the prime industry partner to the Department of Defense. So starting with Sentinel. Earlier this month, the DoD submitted to Congress certification of the Sentinel program as part of the Nunn-McCurdy process. This certification validates the need for the land-based leg of the triad and continued confidence in the Sentinel weapon system, the critical role it plays in safeguarding global security.

DoD and the Air Force are working to restructure the program to reflect the latest cost and schedule estimates. The majority of the cost growth is expected to occur in the production phase of the program, which is beyond the current EMD phase and outside of the future year's defense program or fight it. We continue to execute on our existing EMD contract, which includes the design, development and testing of the full system. We are partnered with the Air Force on completing the design of aspects of the system and how many of the systems components already in development and tests, including all three stages of the missile, command and launch subsystems for launch activation, security and systems monitoring, as well as transportation and support equipment.

The progress we've made on the program is significant, and we remain committed to partnering with the U.S. Air Force to identify ways to reduce the costs associated

with feeling this system. So turning to the air leg of the triad. The B-21 is progressing well through the testing program, and as you know, has entered low-volume initial production.

The team continues to perform exceptionally well, and we remain within our schedule and cost estimates. As we recently shared, B-21 test pilots report that the aircraft is flying like the simulator, which is another indication that our digital environment has effectively predicted the performance of the aircraft, thus reducing new discovery and risk. For these reasons and more, we continue to believe in the significant value this program will create for customers and shareholders over time. It's important to note that while the B-21 program is very important, it contributes less than 10% of our total sales, and we expect that to remain the case through the decade.

Assuming stable economic conditions and continued strong performance by our team, we also expect program margin dollars to grow annually from here as we complete the EMD program and for five lots of production move into advanced production awards on the more profitable lot and beyond and add modernization and sustainment revenue to the program. As you can see, our portfolio includes a compelling mix of technology-driven capabilities and franchise programs that are well aligned to the evolving needs of all of our customers. As a result, we've grown our organic revenue at greater than 5% compound annual growth over the past five years, including 5% growth projected in our increased 2024 guidance. We also continue to rapidly expand our cash flows, including generating over \$1 billion of free cash in the second quarter.

Based on the strength of our portfolio, backlog and performance trends, we are reiterating our long-term cash flow outlook, which assumes a greater than 15% compound annual growth rate through 2026. To support growth in our business, we're maintaining our investments and capabilities across the company. We continue to target \$1.8 billion in capital expenditures this year, which is around 4% of revenue and well above the industry average. Including R&D, we're investing approximately \$3 billion in our portfolio.

At the same time, we're efficiently returning capital to shareholders, including \$2. billion in the first half of the year. In May, we increased the dividend by 10%. This is our 21st consecutive annual increase as we continue to focus on delivering competitive sustainable dividend growth. Before I turn the call over to Dave to provide more details on our financial performance and outlook, I'd like to thank our team for another great quarter as we continue to execute on our long-term strategy.

We have an outstanding portfolio, a high-performing team and a bright outlook for the future. So with that, I'm going to turn the call over to Dave.

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

Thanks, Kathy, and good morning, everyone. Before covering our Q2 results and outlook, I'd like to take a moment and provide some context around our financials given the recent segment realignment. As Kathy noted, the Strategic Deterrent Systems division, which includes Sentinel and other related programs moved from our Space Systems segment to our Defense Systems segment effective July 1. Second quarter results have been reported in the prior organizational structure given the effective date of the realignment, but we've provided a table in the earnings release and earnings slides the recast sales and margin for current and historical periods under the new organizational structure.

Moving forward, we will report third quarter results and beyond under the new structure and our updated financial guidance is also under the new structure. So with that, let's get into our second quarter results. Starting with demand. Q2 net awards totaled over \$15 billion, generating a book-to-bill ratio of 1.5 times and increasing our backlog to over \$83 billion.

As a result of our strong year-to-date performance, we now expect a full year book-to-bill ratio of more than one time sales. Turning to our top line results on Slide 4 of our earnings deck. Second quarter sales were \$10.2 billion, an increase of 7% compared to the same period in 2023. All four segments generated year-over-year growth again in Q2.

Looking ahead to the second half of the year, we expect a gradual ramp in our quarterly sales profile with Q3 sales projected to be roughly in line with Q2. Aeronautics' second quarter sales increased by 14%, with similar drivers to Q1, higher volume on B-21, F-35 and Triton again led the way. At DS sales grew by 7% primarily due to higher volume on certain military ammunition programs and high volume from the timing of materials on GMLRS. Mission Systems sales increased by 5%, with continued strong growth on advanced microelectronics programs, our Marine Systems portfolio and SEWIP.

And at Space, sales were up by 2%, driven by growth on the SDA transport layer programs and GEM 63 solid rocket motors, partially offset by lower sales in the restricted space portfolio. Bottom line results were also very strong with segment operating income up 5% year over year and total operating income up 13%. These results reflect another solid quarter of overall program performance, as well as lower corporate unallocated expense. AS operating income grew by 6%, generating an operating margin rate of 10% for the second straight quarter.

These results have provided an example of how strong program performance, focused productivity initiatives and indirect cost efficiencies can generate margin rates at these levels even as we ramp on B-21. Speaking of B-21, there were no significant changes to our LRIP EAC again this quarter. There are currently 21 aircraft in baseline for the first five LRIP lots and another 19 production aircraft subsequent to these for which we have not to exceed or NTE pricing. These prices were set in 2018, and given that the production for those lots was well into the future, the average unit NTE price was set above the average LRIP price.

The NTE lots include an economic price adjustment clause to protect against certain inflationary pressures. Pricing, final quantities and terms and conditions have yet to be fully negotiated for these additional aircraft. Based on our current projections, we expect to be able to execute the NTE lots profitably. As you think about the trajectory of the overall program, we expect to begin work on long lead items related to the NTE lots in 2026.

x
Save 55%*

Overall production will continue to ramp through the second half of the decade. And we expect that production sales will become larger than EMD beginning in 2026. Other B-21 efforts for modernization and sustainment will also begin to grow over the next couple of years, and are expected to generate profit rates that are accretive to the overall program.

Taking all these factors together, we currently project that margin dollars for the overall program will gradually expand going forward, as Kathy outlined. Defense Systems had a particularly strong quarter, with operating income up 23% and a margin rate of 13.5%. Higher net EAC adjustments and favorable changes in contract mix contributed to their significant year-over-year improvement. At Miss Systems, operating margin rate was 13%, which was lower than Q2 of last year.

Similar to Q1, this was a result of lower net EAC adjustments and changes in contract mix toward more cost-type contracts. While margin rates at current levels remain very competitive, they are below MS' historical performance, and we continue to see opportunities to improve margins in the second half of the year. These improvements will be driven by continued investments we're making in our factories to improve performance and increase production volumes, as well as from the business mix shifting to more fixed price work. Space had another solid quarter of operating performance with operating income increasing 14% from the prior year, generating a margin rate of 9.1%.

We've seen improvements in space program performance for multiple quarters now as a result of deliberate actions we've taken in the business. Moving to earnings per share on Slide 6. Q2 diluted EPS was \$6.36. This represents an increase of 19% from the prior year, driven by continued strong growth in segment performance, as well as from higher net pension income and lower corporate unallocated expenses.

Rounding out our Q2 results is cash flow. We had an excellent quarter of cash generation with Q2 free cash flow of \$1.1 billion, up 80% compared to our results from Q2 of last year. And on track with our expectations for the full year. We

x
Save 55%*

returned approximately \$900 million to investors in Q2 via dividends and share repurchases, while also continuing to make strategic investments in our business

Slide 7 includes our latest segment guidance based on our new organizational structure. We are increasing our sales guidance at both AS and MS, neither of which were affected by the sector realignment. AS is now projected in the high \$11 billion range and MS is projected in the mid-\$11 billion. The increases are driven by the strength of their year-to-date results and expectations for the rest of the year.

As we indicated on our Q1 call, Aeronautics sales are expected to flatten out in the second half of the year based on timing of materials and production schedules. We've also updated our margin expectations for AS and MS. We now expect a margin rate at Aeronautics of mid- to high 9%, reflecting their ability to generate strong margins across their mix of mature production programs and early stage development programs. The increase at AS offsets the decrease in margin rate at MS, which is now projected at low to mid 14%.

At DS, we've increased our sales guidance this year to roughly \$9 billion. This reflects the realignment of the SDS division to DS, which is expected to generate sales this year of roughly \$2.7 billion. The increase also reflects our expectations for higher sales volume associated with ammunition and weapons replenishment. We expect Space sales to be relatively flat this year, projected in the mid- to high \$11 billion range and to be down somewhat in 2025.

This profile is driven by the removal of NGI and the restricted program during 2024, which collectively had a run rate of about \$1.5 billion in annualized sales. Those headwinds affect both this year and next, of which the larger impact will be experienced in 2025. We expect the rest of the space portfolio to continue to grow. Overall, we expect a relatively stable level of margin dollars in space in 2025 as the margin rate grows and offsets pressure from lower volume.

Space's guidance also reflects higher intercompany sales, primarily associated with propulsion activities in support of the Sentinel program. This also has the effect of increasing company level eliminations to roughly \$2.7 billion. We expect a margin

rate at DS of approximately 10% this year and a low 10% rate at space given the shifts in the portfolio. In total, we now expect company level sales of \$41 billion to \$41.4 billion, representing 5% growth at the midpoint.

We continue to expect segment OM dollars to grow at roughly the same rate as sales. We've lowered our expectations for corporate unallocated expense to \$150 million based on year-to-date trends. We continue to expect corporate unallocated expense to be weighted toward the second half of the year, consistent with prior years. We've increased our expectation for the federal tax rate to the mid-17% and slightly lowered our expectation for interest expense to roughly \$650 million.

As we've noted in prior quarters, we're monitoring for any favorable or unfavorable updates in tax legislation, audits and appeals processes that by their nature, are factored into our guidance. And based on the latest plans for a higher volume of share repurchases, we've lowered our estimate for weighted average shares outstanding to the mid \$147 million. Altogether, our strong performance and outstanding results in an increase of \$0.45 to our diluted EPS range. We had a strong first half the year, and we're looking forward to continuing to create value in the second half and beyond.

So with that, let's open up the call for questions.

Questions & Answers:

Operator

Thank you. [Operator instructions] Our first question comes from Kristine Liwag with Morgan Stanley. You may proceed.

Kristine T. Liwag -- *Analyst*

Hey. Good morning, Kathy and Dave.

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

Good morning.

Kristine T. Liwag -- *Analyst*

I want to understand a little better the 19 B-21s under not to exceed pricing agreements. I mean, I understand that the ceiling for the average unit price is high than the first 21 aircraft, but how do we get comfortable that these next 19 aircraft are indeed profitable as final pricing is yet to be determined. And then, also as a follow-up, I think you both mentioned the Lot 6 is more profitable. And I just want to clarify, this means absolute positive margin on the program? And -- or is that a relative comment to the previous lots I just want to understand the dynamics a little bit better on the B-21.

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

Sure, Kristine, happy to clarify a few of those points. As you've noted, the NTE lots that follow the first five LRIP lots are currently projected to be more profitable than the LRIP lots. And to clarify that further, we are projecting a positive profit rate in Lot 6 based on our current projections. So to your point, those NTE prices are set higher than the prices that are expected for the first five lots and with cost efficiencies that we're working hard to drive and program performance and productivity efforts we've made, much in progress.

Our current projections indicate positive profitability for those lots.

Operator

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

Scott Deuschle -- *Deutsche Bank -- Analyst*

Good morning. Thanks for taking the question.

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

Good morning, Scott.

Scott Deuschle -- *Deutsche Bank -- Analyst*

Dave, just to follow-up on Kristine's question. Is the difference on B-21 units, 22 to 40 that they have both a higher average base price and the EPA cost protection on units 1 to 22 also have that EPA protection?

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

The I think you're right, those are both important points about the NTE lots that they are set higher. They also do include an EPA clause that is one we're monitoring carefully. So both are important to keep in mind as eventual pricing and terms and quantities are finalized for those portions of the program.

Scott Deuschle -- *Deutsche Bank -- Analyst*

OK. Great. And then, Kathy, there was a news article a while back about the issue in the industry faces and sourcing ammonium perchlorate for making solid rocket motors that something you guys have made some good headway on.

And based on your comment on GMLRS output being up 60%. It sounds like the answer is yes, but just curious for your perspective.

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

Yes, Scott, thank you for the question. We did recognize this as a constraining factor in our supply chain for solid rocket motors four or five years ago, and the team brought forward a business case, which we funded to create an alternate supply, and we have done so, which gives us more confidence in our ability to manage the supply. We also, of course, are buying IP from other sources as well. We are not the single supplier of our own AP, but we did add to the overall production capacity, which has improved our ability for predictability on SRM, solid rocket motors.

Operator

Thank you. Our next question comes from Rob Stallard with Vertical Research. You may proceed.

Robert Stallard -- *Analyst*

Thanks so much. Good morning.

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

Good morning.

Robert Stallard -- *Analyst*

Kathy, on Sentinel, there's been some reports that the customer is not happy with the way this program has been progressing so far. And I was wondering, first of all, what sort of risk is there that Northrop could be on the hook for additional charges on this program? And then, secondly, what you're trying to do practically to improve the cost profile on Sentinel?

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

Yes. Well, thank you. The DoD did a thorough review of a program as part of the Nunn-McCurdy process, and they were very transparent about the results of that review. For those of you who haven't seen it, they did a press release, they conducted media interviews about a week and a half ago to share those results and they met with many members of Congress.

And in that process, they have not pointed to industry performance as the cause of cost growth. The things that they have pointed to include inflation, obviously, particularly as we look at the deployment, there's a big construction component to this job and also the assumptions that were made many years ago that underestimated the complexity of the program. And those were the two primary cost growth drivers that were identified. We are working with the Air Force to identify ways to perform better than those cost estimates.

We will continue to do that. We are looking at everything from design alternatives that they have referenced in the restructure of the program to ensuring we have the right team in place to execute on every part of the program in that deployment and production phase. And of course, we are continuing to bolster our own staff and systems engineering on the program. But the reality is that most aspects of the program are progressing very well, and the Air Force has publicly made those comments.

We are very focused on the ground in the structure, which is the piece of the program that is driving the vast majority of the cost growth, and that's what our focus will continue to be through the restructure.

Robert Stallard -- *Analyst*

OK. Thanks very much.

Operator

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

Jason Gursky -- *Analyst*

Yes, Kathy, just a quick follow-up to that last commentary. There was an article yesterday with some comments from somebody up on the hill, senator, I think that did mention Northrop. So I'm just kind of curious if we can some context about your recent visit, it sounds like you made up to the hill and why you'd have somebody in the in Congress making some comments and a little bit contrary to what you just mentioned.

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

Well, I'm not going to comment on any individual meetings that I had, but I have had a number of meetings with members of Congress on both sides of the aisle, and they have generally been very supportive of the need for the program and our team's role in that program. And I will also just note that the Department of Defense spe-

for the program and their findings on the Nunn-McCurdy and have spoken very clearly about that. The final thing I'll suggest is that while not everyone is a supporter of the land-based leg of the triad, you can look at the vote and the appropriations, which have fully funded the program, and it's more reflective of the landscape I painted, which is broad-based congressional support for the program and our role in it.

Jason Gursky -- *Analyst*

That's helpful. Thank you.

Operator

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

Sheila Kahyaoglu -- *Analyst*

Good morning, Kathy, Dave, and Todd. Thank you. Maybe if we could just talk about your Mission Systems business. It's been a solid double-digit business, and you saw it come down this quarter.

How do we think about that mix impact lower EACs and there's 100 basis points of cost ramp in the second half versus H1. How does that evolve? And how do we think about that longer term?

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

The way I would characterize that is, I think, first of all, you've touched on a key point that the mix in MS has shifted over the last few years. to be more heavily cost type in nature. We think that mix will shift back in the direction of more fixed price work over the next several years. A lot of the growth in MS in recent years has been largely cost-type development programs, leading technology efforts across its multiple mission areas.

x

Save 55%*

And as a result, its cost type mix has gone from the mid-30% back in 2021 to the mid-40% this year, gradually that will shift downward over time to include the second half of this year when consistent with last year, some of our greater sales volume in the second half in MS will be driven by programs that are more predominantly fixed price in nature, and that will blend the mix upward even as soon as the second half of this year. But I think another important point is the set of deliberate actions we're taking to improve productivity and performance and cost efficiency in our Mission Systems business as we're scaling to meet increased demand in our factories. All those improvements there are being felt already in the business and are another driver of our confidence in second half margins for MS being higher than those we've delivered in this half. We're working closely with our suppliers and our production teams in MS to continue to deliver on those efforts and expect progress in the second half and beyond.

Sheila Kahyaoglu -- *Analyst*

Thank you.

Operator

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

Seth Seifman -- *Analyst*

Thanks very much and good morning. I wanted to dig in a little bit on the space decline you talked about for next year. It looks like off of the revised numbers, maybe it's a modest decline this year. When we think about what's coming next year and the ability to grow in I think you talked earlier, Kathy, about growing again in 2025.

The ability to grow in 2025 relative to the 5% growth rate that you're expecting for this year. Is it possible to make any comments about that at this point?

x

Save 55%*

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

Sure. With the increase in our guidance this quarter, we expect 5% growth again this year following a period, as I said, of about 5% compound annual growth for the last five years. So looking forward, we'd expect solid growth across three of our four segments with the strong demand that I talked about earlier in the call, balanced across the portfolio. Space is likely to be the exception to that next year.

We are guiding around flat this year and down modestly net. And that's due largely to the impact of NCI and the restricted program that we talked about earlier this year being canceled, and then we do expect space to return to growth in 2026. So it's not too soon to provide a detailed guide for 2025 at a company level, but that gives you a sense of the dynamics that we're expecting in the various segments. And with the fraud-based portfolio that we have, the slight decline that we expect in sales in the next year do not change our outlook for the company as a whole.

Seth Seifman -- *Analyst*

OK. OK. And then, maybe as a quick follow-up. In Aeronautics, we've seen some fairly strong margin performance early this year and led to the guidance increase. I guess, are there specific things to point to for the second half that will pull that down below 10%.

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

Sure, Seth. Happy to comment on that further. To your point, it was a really solid first half of the year and a solid second quarter for the AS business, top and bottom line performance were strong. And really since the beginning of the year, we've been projecting and noting that the sales growth rate would moderate a bit in the second half of the year because of the timing of top line items in aeronautics, supplier deliveries and such, both on B-21 and on programs like F-35 that were going to lead to higher volume in the first half of the year than we saw a year ago.

So that's where we've seen the really strong year-over-year growth rates in the first half. We've been able to increase our guide for both sales and margin rate for the year. But to your point, it will involve slightly slower growth and slightly lower margin rates in the second half. We have initially guided 9.5% for the year and have now increased that rate because of the first two quarters at 10%.

So we're continuing to project a really strong rate for the year. And I think that's evidence of the fact that we have a diversified mix of programs in AS and programs like our support for F-35, as well as Triton E-2D and others are in healthy production levels where we're doing a great job for our customers and delivering strong results for investors.

Operator

Thank you. Our next question comes from Gavin Parsons with UBS. You may proceed.

Gavin Parsons -- *UBS -- Analyst*

Thanks. Good morning.

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

Good morning.

Gavin Parsons -- *UBS -- Analyst*

I appreciate all the detail on B-21. That's really helpful, especially in terms of EBITDA dollars growth. When do you foresee the peak margin rate headwind occurring for that program?

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

So Kevin, what we have shared today suggests our modeling of the program would see increased dollar growth from here and on earnings and modest sales growth

So you can anticipate, even though we didn't specifically outlined that we are at the trough of margin rate performance on the program in our current modeling.

Gavin Parsons -- *UBS -- Analyst*

Got it. That's helpful. And then, I guess on the expectation for equitable adjustment on Lot 6 or beyond. I think there was some expectation that there might be one of the first five LRIPs.

Is it more contractual now on the board expectation?

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

So the difference with the NTE pricing is that the pricing itself has an economic price adjustment clause in it for the EPA contracts, which, of course, we have not negotiated or definitized. The LRIP did not have an EPA clause. So any inflation risk that we get on those contracts is additive to the term.

Operator

Thank you. Our next question comes from Cai von Rumohr with TD Cowen. You may proceed.

Cai von Rumohr -- *Analyst*

Thanks so much. So help me understand on B-21. I mean, you took close to \$1.6 billion charge over five lots, that's roughly \$300 million a lot. So I assume that's moving from about zero last year up to \$300 million negative.

How do you get enough profit to offset that? Or when you talk about profit dollars and improving, are you talking from an accrued basis where you've taken the charge already?

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

Right. Cai, it's the latter. We took that charge last year. So we're talking about the anticipated results from the program going forward.

Cai von Rumohr -- *Analyst*

Got it. And then, secondly, they're talking about restructuring the Sentinel program. Is that likely to be, in your opinion, Kathy, an opportunity or a risk for Northrop Grumman.

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

At this point, Cai, what I would say is that the cost growth that is being talked about and which drove the Nunn-McCurdy is mostly outside of the EMD phase of the program, which, of course, is what we are on contract for and therefore, what our financial projections reflect. And we do reflect the modest cost growth that we're expecting in the EMD contract in our financials. So you see that reflected in the Q booking rate. And I would say we've taken a cautious approach on our booking rate at this point as we normally do.

at the beginning of the program. And as we perform and achieve more percentage performance milestones over the course of the program, we would expect that booking rate to improve.

Operator

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

Douglas Harned -- *Analyst*

Hi. Good morning. Thank you. Kathy, when you talked -- you had a really big quarter this year for bookings after last quarter was pretty soft.

And you're looking at being above 1.0 for the year. How should we think about the outlook this year in terms of bookings? And I'd say in two dimensions. One is

growth, U.S. versus international.

And then, second, which segments are we looking at where you expect to see that over the -- see some good growth over the next two quarters?

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

Yes. So as Dave said, we are now expecting book-to-bill in the year over one after very strong second quarter. We do see lumpiness in awards, as we've talked about before, but consistently has been performing on an annual basis with book-to-bill over one. And this year, it is again expected to be reflecting our mix of domestic versus international sales because awards are going to be strong in both categories with international bookings being stronger this year than they have been in the past in domestic bookings remaining strong.

In terms of the segments that are going to drive that, we've seen it shift more to shorter-cycle businesses. So the strong bookings are more concentrated now in new defense systems and in Mission Systems than they are in AS and space. But of course, I'll point that in both those segments, we've had strong -- they've been the key driver of strong bookings in the past and so they still have a really solid backlog.

Douglas Harned -- *Analyst*

Yes. I guess part of what I was getting at is if you're looking at -- we're looking at unfortunately fairly flat budgets in the U.S. but a lot of growth outside -- should we expect to see over the next couple of years any kind of a shift in mix with a higher percentage of international sales.

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

I would say we are more international sales than we are expecting our international sales to grow at a faster rate than our domestic. But also when you look at bookings and the strength of our alignment with the National Defense Strategy and the prioritization, particularly of the triad and the growth that we expect on all three of

the programs as they move through development and into production, we do believe that they will be well supported in the budget, and we'll see them take more share of the budget overall, even though each one of them is well below 1% of the overall DoD budget, they are well prioritized within the spending profile.

Operator

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

Myles Walton -- Analyst

Thanks. Good morning. Just had a quick follow-up question for you, Kathy, in your remarks earlier in the prepared remarks, you talked about high single-digit percentage of revenue on the Sentinel and B-21 and staying consistent with that over the next several years. And I guess I was expecting that the B-21 would drip into double digits within that time period, understanding that Sentinel might have a smoother or slower growth rate.

Is that correct or incorrect in this assessment?

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

No. And it's why we included it to clarify that even though you see budget profile from department that show growth, that includes things that aren't on our contract as the government needs to staff up to be able to test to be able to support, to be able to build a sustainment to organization to house the aircraft as we deliver the aircraft. So there are a lot of things in that budget beyond our contract value. And with the dynamics that I described with EMD moving toward completion over the next handful of years and meeting IOC on the program with the production meeting its quantity level and then starting to flatten off.

And with modernization and sustainment coming online, that whole mix keeps us generally in that high single-digit range, especially as the rest of the portfolio grows.

as well.

Myles Walton -- *Analyst*

OK. Very good. And then, the space booking -- excuse me, space performance in the quarter, it sounded from your tone that it had improved. Are we now back to positive EACs or are we just less negative EACs that we're seeing?

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

I can take that one. The EACs for Q2 for space were less negative than the last couple of quarters, clear improvement there in performance in the business, still a few small negative items. But clearly, as you saw from the year-over-year booking or margin rate improvement and the overall margin rate that we're now expecting the full year in space, there's been demonstrable progress there, really related to the actions we've been taking for the last year to improve program performance, deliver cost efficiencies, deliver affordability for customers as we do it. So certainly a good news part of the story there.

Operator

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

Matt Akers -- *Wells Fargo Securities -- Analyst*

Good morning. Thanks for the question. Can you comment on the Navy new fire, FXX, just what you're hearing on timing there and if you still have plenty to bid on that program?

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

Yes. We have not received any updates that would suggest the Navy is changing their approach. They are in competition now for selection to occur next year. And

terms of our overall collection of opportunities continue to believe that the Department of Defense will move forward with sixth generation platforms.

The timing is a bit influx on many of them as they sort out budget priorities. But we are confident that we're well positioned when and if they do move forward.

Matt Akers -- *Wells Fargo Securities -- Analyst*

Great. And if I could do a follow-up. I guess Spirit AeroSystems is a supplier on B- -- any thoughts around the acquisition there with Boeing? And if there's a chance would bring that work kind of in house?

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

Yes. I'm not going to comment on specific discussions that we've been having with Spirit. But generally, we acknowledge that they are a supplier, and we have agreements in place with them that we would any owner of the company to adhere to as we move forward.

Operator

Thank you. Our next question comes from Pete Skibitski with Alembic Global. You may proceed.

Peter Skibitski -- *Analyst*

Good morning, guys. Kathy, I think it was on the last call, you talked about an increasing amount of Triton export opportunities. I was wondering if you could give us a sense of timing for when those might get signed off on and maybe size some of the opportunities? Thanks.

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

Yes. So we are excited that both NATO and Norway have expressed interest in Triton, and we are hopeful that announcements will be coming shortly on both. A

as we look to build Triton for the U.S. and Australia, this simply adds to the production line outlook for Triton through the decade.

And so, we had envisioned this day coming where more countries would get the opportunity to see Triton once it was fielded has a tremendous ability to surveil large areas of ocean. You can think of the relevance to that in the Pacific, which is what was attractive to Australia and the U.S. Navy, but of course, in the Arctic, this is an area of great importance as well, which is driving to NATO and the Norwegian interest.

Peter Skibitski -- *Analyst*

Great. Thank you.

Operator

Thank you. Our next question comes from Robert Spingarn with Melius Research. You may proceed.

Scott Mikus -- *Melius Research -- Analyst*

Hi, it's Scott Mikus on for Rob Spingarn. Kathy, I wanted to ask about the Sentinel program. It had an 81% increase in cost, but the DoD's Cape office said that their confidence interval on that estimate was only about 50%. So if the estimates end up being higher or lower, can you talk about opportunities where you think you can lower the cost of the program? And then, as a follow-up, although nuclear modernization is a high priority, budgets aren't unlimited.

So how concerned are you that cost growth in Sentinel could result in it being truncated or potentially B-21 end up being a bill payer with the Air Force's budget?

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

Yes. A couple of things to for you in answering those questions. The first is a reminder that the cost growth that is projected is indeed that a projection over a

very long period of time. It covers not just the work that we're doing right now to design, develop and tests, which will largely be through the remainder of this decade.

The majority of those cost growth projections come for the fielding building out the missile silos for the system, 450 of them, and that doesn't happen really until the next decade. So that's why there's so much uncertainty. It's like any of us sitting here and trying to project what costs might look like 10 to 15 years from now, and that's what's baked into those estimates. The second part of your question is around the 80% growth.

There's so much of that is well into the future. There are still decisions that the Air Force can make today, that can drive solutions that reduce that cost projection. And that is what they're doing in the restructuring, looking at those options, and we are partnering with them to do that very committed to help them do that.

And of course, on many of Northrop Grumman's program, we are performing well below the government's independent cost estimates, which is what these are. These are not industry's estimates. These are the government cost estimates. And this is not growth on the current contract.

This is projections of future growth. So with all of that in mind, there is time here to work through a number of factors to determine what the actual cost growth would be and how that gets incorporated into future year defense programs, but it is not expected to have a significant impact in the next five years, and the Air Force has made that clear.

Scott Mikus -- *Melius Research -- Analyst*

Thank you.

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

Of course.

x

Save 55%*

Operator

Thank you. Our next question comes from Peter Arment with Baird. You may proceed.

Peter Arment -- Analyst

Thanks. Good morning, Kathy and Dave. Thanks for all the incremental details on 21 super helpful. Just Dave, quickly on working capital, just dynamics going forward here and then how we're thinking about that as it rolls into '25 just given all the growth that you guys are enjoying?

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

Sure. Clearly, a really strong Q2 for free cash flow performance, working capital very much an integral part of that. I think it's a good opportunity to take a step back and look at the rest of this year and beyond? And what's factored into our multiyear outlook and our guidance for this year. And for working capital, the answer is essentially that our expectations are pretty flat that we're already performing at a very high level, very strong level for working capital and that we're not anticipating additional efficiencies nor are we anticipating erosion to those levels.

So when we talk about a 15% plus free cash flow CAGR from 2023 to 2026. That's not driven by further working capital efficiencies. It's driven by the expansion of operating profits as we continue to grow the top line, and we deliver on margin expansion opportunities. Capex is at peak levels this year as it was last that will decline going forward, both in real dollars and clearly as a percentage of sales toward our longer-term target in the 3% range.

And then, we should see modestly stronger CAS pension recoveries as we show in our latest projections earlier this year based on the actuarial environment today. And then, the Section 174 impact on cash taxes will continue to decline each year. So that combination of factors is what leads to the 15-plus percent free cash flow

growth in our outlook and working capital is essentially a flat element of that outlook.

Peter Arment -- *Analyst*

I appreciate the details. Thanks.

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

You bet.

Todd Ernst -- *Vice President, Investor Relations*

And Josh, we have time for one more question.

Operator

Thank you. And our final question comes from David Strauss with Barclays. You may proceed.

David E. Strauss -- *Analyst*

Thanks for squeezing me in and I appreciate all the additional color on B-21, very helpful. Kathy, can you -- you've talked about the company eventually getting back this 12% margin range. Today, you're at 11%. You talked about B-21 today, not really being much of a headwind as we think about margins going forward.

Can you talk about that progression back to 12%, how you see that kind of playing out over the next couple of years?

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

Sure. So we've talked about several factors. The first is getting the macroeconomic headwinds behind us related to inflation flowing through our contracts, the disruption and challenges that we've had with supply chain deliveries, and those are largely getting behind us, although we do still have some contracts that is flowing

x

Save 55%*

through, and we're seeing those impacts, as we talked about in Mission Systems today. But as those headwinds dissipate, then it really is about the strength of the portfolio shining through in the operating results.

And you're starting to see that take hold. What I would say is that from a cost efficiency standpoint, the team is making sure that the business is sized appropriately and everything from human capital to facilities our infrastructure. We also are investing in digital enablement, as you know, which is a tailwind to program performance as we've demonstrated on B-21 with our ability to adhere to modeling that predicts future performance and then hit that performance in the product, that is derisking our programs and driving improved margin opportunity. And then, some more structural items like the mix shift that we spoke about on the call.

Our cost business, which we've had a heavy concentration up here in these last few years, including programs like Sentinel with lower booking rates, which will, over time, move toward fixed price and more profitable programs. And then, of course, international, which is a portfolio tailwind as more of our business comes from international forces. So it's that full combination of paths that we are working. We're showing progress on each as we move forward, and it bolsters our confidence that we can drive this business to another 100 basis points of margin performance this decade.

David E. Strauss -- *Analyst*

As we sit here today, would you expect margins to tick up next year off of the 11% level?

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

I would.

David E. Strauss -- *Analyst*

Thanks. Appreciate it.

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

Thank you. All right. So with that, I'd like to conclude by once again thank you to team for a fantastic quarter. And in particular, I want to recognize Mark Taylor who is retiring from our company tomorrow after a distinguished Northrop Grumman career and over a decade on our executive leadership team.

And also I want to note that in the coming months, Dave, Todd and I look forward introducing Ken Crews, who is here with us in the room to our investor community as our incoming CFO effective October 1. So in the meantime, we look forward to talking with you in October and seeing you over the course of the summer, and thank again for joining our call today.

Operator

[Operator signoff]

Duration: 0 minutes

Call participants:

Todd Ernst -- *Vice President, Investor Relations*

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

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

Kristine T. Liwag -- *Analyst*

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

Kristine Liwag -- *Analyst*

Dave Keffer -- *Corporate Vice President and Chief Financial Officer*

Scott Deuschle -- *Deutsche Bank -- Analyst*

x
Save 55%*

Robert Stallard -- *Analyst*

Rob Stallard -- *Analyst*

Jason Gursky -- *Analyst*

Sheila Kahyaoglu -- *Analyst*

Seth Seifman -- *Analyst*

Gavin Parsons -- *UBS -- Analyst*

Cai von Rumohr -- *Analyst*

Douglas Harned -- *Analyst*

Doug Harned -- *Analyst*

Myles Walton -- *Analyst*

Matt Akers -- *Wells Fargo Securities -- Analyst*

Peter Skibitski -- *Analyst*

Pete Skibitski -- *Analyst*

Scott Mikus -- *Melius Research -- Analyst*

Peter Arment -- *Analyst*

David E. Strauss -- *Analyst*

David Strauss -- *Analyst*

[More NOC analysis](#)

[All earnings call transcripts](#)


x

Save 55%*

This article is a transcript of this conference call produced for The Motley Fool. While we strive for our Foolish Best, there may be errors, omissions, or inaccuracies in this transcript. As with all our articles, The Motley Fool does not assume any responsibility for your use of this content, and we strongly encourage you to do your own research, including listening to the call yourself and reading the company's SEC filings. Please see our [Terms and Conditions](#) for additional details, including our [Obligatory Capitalized Disclaimers of Liability](#).

The Motley Fool has no position in any of the stocks mentioned. The Motley Fool has a [disclosure policy](#).

Ad




Alert: Top Cash Back Card Now Offers 0% Intro APR Until 2026


Enjoy 0% intro APR on purchases and balance transfers well into 2026—plus up to 5% cash back in popular categories.

Click Here to Start Earning More ›

STOCKS MENTIONED



Northrop Grumman
NOC
\$512.85 (4.24%) \$20.88



Motley Fool Stock Advisor's Latest Pick
[Get Access](#)
731% Avg Return*

**Average returns of all recommendations since inception. Cost basis and return based on previous market day close.*

RELATED ARTICLES



Northrop Grumman (NOC) Q4 2024 Earnings Call Transcript



Northrop Grumman (NOC) Q3 2024 Earnings Call Transcript



Northrop Grumman (NOC) Q1 2024 Earnings Call Transcript



Northrop Grumman (NOC) Q4 2023 Earnings Call Transcript



Northrop Grumman (NOC) Q3 2023 Earnings Call Transcript

MOTLEY FOOL RETURNS



Stock Advisor

A MOTLEY FOOL SERVICE

Market-beating stocks from our flagship service.

STOCK ADVISOR RETURNS

731%

S&P 500 RETURNS

146%

x

Calculated by average return of all stock recommendations since inception of the Stock Advisor service in February of 2002. Returns as of 04/09/2025.

Discounted offers are only available to new members. Stock Advisor list price is \$199 per year.

Join Stock Advisor

Save 55%*



Making the world smarter, happier, and richer.

© 1995 - 2025 The Motley Fool. All rights reserved.
Market data powered by [Xignite](#) and [Polygon.io](#).

ABOUT THE MOTLEY FOOL

- About Us
- Careers
- Research

OUR SERVICES

- All Services
- Stock Advisor
- Epic

AROUND THE GLOBE

- Fool UK
- Fool Australia
- Fool Canada

[Newsroom](#)

[Epic Plus](#)

[Contact](#)

[Fool Portfolios](#)

[Advertise](#)

[Fool One](#)

[Motley Fool Money](#)

FREE TOOLS

AFFILIATES & FRIENDS

[CAPS Stock Ratings](#)

[Motley Fool Asset Management](#)

[Discussion Boards](#)

[Motley Fool Wealth Management](#)

[Calculators](#)

[Motley Fool Ventures](#)

[Financial Dictionary](#)

[Motley Fool Foundation](#)

[Become an Affiliate Partner](#)

[Terms of Use](#)

[Privacy Policy](#)

[Disclosure Policy](#)

[Accessibility Policy](#)

[Copyright, Trademark and Patent Information](#)

[Terms and Conditions](#)

[Do Not Sell My Personal Information](#)

x

Save 55%*