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Chair, CEO & President

ANALYSTS

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Presentation

Douglas Stuart Harned
Bernstein Institutional Services LLC, Research Division

Okay. Good morning. I'm Doug Harned, Bernstein's Global aerospace and defense analyst. I'm thrilled to have back with us, again, Kathy Warden, Chairman and CEO of Northrop Grumman, and we're going to go sort of straight into Q&A here.

Kathy J. Warden
Chair, CEO & President

Great. Thanks, Doug. It's great to be back with you. Just before we get started, I do want to remind everyone that I may make forward-looking statements, and those statements have inherent risks. Those risks are outlined in our SEC filings, which you can find on the Northrop Grumman website.

And Doug, I would just say a lot has happened since I was here with you on this stage a year ago. We are certainly living in a dynamic and complex environment in the national security space that has led to an increased demand both from the United States and our allies for the kinds of capabilities that Northrop Grumman provides, and we've seen that result in robust backlog growth. We are projecting mid-single-digit sales this year with acceleration into next. And we have really intentionally focused on building with speed and laying in capacity necessary to produce at scale.
This is what we are hearing from our customers. We are being responsive to that proactively. And you will see that we continue to invest in our business to position ourselves for that growth. We have a lot of opportunities. I'm sure your questions will lead us into discussions about what those opportunities are. And we hope today to provide some clarity also on our capital deployment plans to support investment in those opportunities and others.

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Question and Answer

Douglas Stuart Harned
Bernstein Institutional Services LLC, Research Division

Great. Thanks, Kathy. I want to start with the budget because we've got a President's budget submitted $1.5 trillion. We -- it's unclear where this is going to come out. It's going to go through Congress. But maybe as a start, can you tell us how you think about the budget process? How we get from this proposal to a reality? What some of the factors are? I mean, I know you're in discussions with lots of people involved in this. And then how you, in Northrop Grumman, manage through the uncertainty?

Kathy J. Warden
Chair, CEO & President

So the base budget of $1.15 trillion that the President submitted to the Congress very much supports the programs in the Northrop Grumman portfolio that are the basis for our guidance this year and our expected acceleration of sales into next year. And I've been spending a good amount of time on the Hill, talking to members of the House and the Senate about their reaction to that budget and their expectations for its passage. And I would say there continues to be strong bipartisan support for national security spending increases and that $1.15 trillion is in the range of what was expected.

And as it flows through markup, we'll see more details, but I feel positive that the base budget that provides the funding necessary for Northrop Grumman programs to continue to execute against their acceleration plans is going to be well supported.

Douglas Stuart Harned
Bernstein Institutional Services LLC, Research Division

Well, you mentioned a lot's happened since we were here a year ago. A lot's happened in the last several months. One of those is war in Iran. So we've used a huge amount of munitions. We've also had a high op tempo. When you think of what's happened there, how does that play into how you're looking at this year and next year, perhaps in terms of demand?

Kathy J. Warden
Chair, CEO & President

We are certainly seeing immediate demand uptick for support and sustainment to ongoing military operations, operations that are happening at a tempo that I haven't seen in a very long time. And this is across our entire portfolio. What's often talked about are the munitions that are being depleted and needing to replenish those. And certainly, this year's reconciliation focuses on large sums of resource to build more munitions more quickly, and we are offering our capabilities and capacity in that regard. And being taken up on that offer by both the primes who build tactical missiles as well as the Department of War.

We are clearly recognizing the urgency to work there. But we are seeing it too with aircraft that are being flown far more than they were anticipated to fly. So for the E-2D, which has been central both in operations in Venezuela and Iran, the Navy has requested an additional 12 aircraft just as a result of this increased op tempo and the need for the capabilities that the E-2D provides. We are seeing that broadly across the Northrop Grumman portfolio. And those resources likely will come from reconciliation bill or potentially a supplemental outside of the base.

Douglas Stuart Harned
Bernstein Institutional Services LLC, Research Division

Now one other aspect of the war in Iran and the war in Ukraine has been the growth in asymmetric warfare with use of low-cost drones, a lot of different things here than we've seen in past conflicts. The administration has been encouraging spending money or plans to spend money on bringing in new suppliers of drones. When you look at this universe, both unmanned systems and Counter-UAS, how does Northrop Grumman play in all that?

Kathy J. Warden
Chair, CEO & President

We play in both marketplaces. Oftentimes drones are thought of as very low-cost high quantity. That's not a segment of the market that we play in, but we definitely play in the mid and upper ends of that marketplace as we do in most areas of defense equipment. We foresee that, that market will continue to grow, and we are offering low-cost options in everything from missiles to Counter-UAS and low-cost interceptors, which we believe will be an increasing part of the defense inventory over time, even though right now, it's

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largely about building more of our weapons that are already in production so that we can very quickly replenish. We know that over time, the desire is to get to weapons that have a lower cost point and can counter a $1,000 drone with a $1,000 interceptor rather than a $3 million interceptor.

Douglas Stuart Harned
Bernstein Institutional Services LLC, Research Division

Well, I mean how -- but also as part of this, there's been this encouragement and openness to bring in a lot of new players into this mix. And there are almost countless of them now. How does -- in the knowing that there seems to be sort of a bias in the administration toward this, how does Northrop Grumman deal with this and compete effectively?

Kathy J. Warden
Chair, CEO & President

We still choose to compete in areas where we have the most competitive differentiation. Often that's technical differentiation. Sometimes it's about the scale at which we can manage complex programs and deliver hundreds, if not thousands of them. Those are areas where we thrive. But that does not mean that we can't scale our operations. So an example of this is our Counter-UAS solution. It is basically taking product lines that we have today with guided munitions, canon-based launchers and offering an alternative to down a drone with a $1,000 option versus, as I said, $3 million interceptor. This is matching the sophistication -- low sophistication of a threat with a solution that is also much more affordable and deployable.

So these are things a company of our size and scale can and does do with the engineering talent and the manufacturing capacity we have, but we also can scale up and build very exquisite systems like the B-21, which is an asset that provides capability no other asset in the world provides. We think that it will continue to be the case that the U.S. and our allies need a mix. It's not one or the other, it's both, and it's just a matter of what will be the mix of these higher end and lower end, more expensive and more affordable solutions.

Douglas Stuart Harned
Bernstein Institutional Services LLC, Research Division

You mentioned the B-21, I'd like to move over to Aeronautics and talk about the B-21. We've heard positive statements from the Air Force on performance, on schedule and I think as we have talked before, I can't remember a major combat aircraft program that has -- seemed to have gone so smoothly this way. A couple of things. One is you have taken a couple of charges on it. Maybe you could explain a little bit about what's happened there? Should we have concerns that you could start to run into problems we've seen in all these old, less successful development efforts?

Kathy J. Warden
Chair, CEO & President

Well, Doug, I appreciate the recognition of how the program is going. That doesn't happen by chance. It has been a lot of hard work. We've had a great partner in the U.S. Air Force and the way they've worked with us in industry. We have an excellent industry team, engineers that I would put up against any in the world in terms of their capability to design this aircraft and then to build it and meet those requirements the first time, and that's what we are demonstrating in tests. And then as a company, we had the foresight to invest to make sure that we were putting resources toward the program to buy down risk through the development phase to smoothly transition into production, and that is indeed what is happening.

So a lot of effort has gone into making the B-21, the success that it is both by the Air Force and by the Northrop Grumman team. We do, as we move through the completion of the test program and into production, look forward to the opportunity to build these faster, and that's the agreement that we have now come to with the Air Force, which also opens up the opportunity for them to potentially buy even more. So that's what to look for as we continue to progress through this year and really proud of how the performance has demonstrated, not just the value of the B-21 and military commanders who have looked at the B-21 are requesting more of them because they see it as game-changing in their ability to conduct operations in their theater.

And the pilots who are flying it say it is an exceptional aircraft, so we're really proud of that.

Douglas Stuart Harned
Bernstein Institutional Services LLC, Research Division

But is there -- when you look at some of the cost issues because you have had a couple of EACs. What's been behind that? And is that anything that we should be concerned about because you always worry when you see one, you might see more?

Kathy J. Warden

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Chair, CEO & President

Right. Two drivers. We've had two charges on the program and two different drivers for each. The first was recognizing the high levels of inflation that had not been anticipated when we initially bid the contract. That was the largest of the charges that we took as a result of the pandemic. We all, not fondly, but recognize and remember the time of high inflationary pressures that we had to incorporate into our cost estimates as we would be building these aircraft over the coming years. And so that was the reason behind the first charge. The program was performing very well.

The second was investment that we put into the program to position ourselves to accelerate rate and a learning that happened in our manufacturing process that did result in a charge. No program is going to be perfect. And so we had that learning, it resulted in some rework and we took that charge. For a program of this size, complexity and duration, this program is performing exceptionally well. But any program of this size does carry with it risk, especially as you move into production for the first time.

But we are retiring those risks with each passing day as the aircraft tests well, and we get through build processes, we are feeling very positive about our ability to continue to deliver on our estimates.

Douglas Stuart Harned
Bernstein Institutional Services LLC, Research Division

Well, one of the things I know when you talked about investment that's so important is the Air Force's desire to accelerate production, get this airplane out-fielded sooner. And then there's a second piece, which is would the program of record be increased? How do you think about those two things in terms of your capital investments and the time line for revenue growth?

Kathy J. Warden
Chair, CEO & President

The capital investments that we've now committed to and we've disclosed about $2.5 billion additional is to facilitize for building at the increased rate. And as we and the Air Force have been talking about for months now, that increased rate allows them to consider how they meet mission requirements and how many aircraft they would want to build to do that. So they are undertaking that analysis now. And certainly, our ability to build faster is a positive factor in those evaluations.

Douglas Stuart Harned
Bernstein Institutional Services LLC, Research Division

And how -- I mean, can you give us -- is it possible to give us any sense of what that revenue trajectory will be? I know it's hard with a program like this.

Kathy J. Warden
Chair, CEO & President

Yes, and hard because as you're acknowledging many of the aspects of the program like the actual build rate are classified facts. But what I can share is that we do expect as a result of acceleration for there to be a step-up in annual sales associated with that faster build rate after we lay in the infrastructure, that's a couple of years out. But even so, as we expend the resources to prepare for that ramp, we are seeing some modest step-up in revenue on the program. We also expect the overall business case for the program to improve with the prospects of building more of those profitable aircraft providing a solid return on this investment that we have committed.

And it's a win-win as all of these partnerships should be. We are getting better returns for our shareholders and the government wants that. But at the same time, they are getting an aircraft that is extremely capable and it's going to be able to be fielded faster.

Douglas Stuart Harned
Bernstein Institutional Services LLC, Research Division

The TACAMO program is an interesting one right now. It's growing. Maybe you could help us understand a little bit about the size of that and what you see as the growth path forward.

Kathy J. Warden
Chair, CEO & President

So it's contributing a couple of hundred million of growth each year, last and this year, as it scales through its development phase, will transition into production in a couple of years. A really important program that supports the Nuclear Command and Control Mission for the United States, and we are building out the mission systems and the aircraft to support that mission all through our Aeronautics

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sector. It's development margins today as is typical, but as I said in a couple of years, transitions into production, so a nice tailwind for value creation.

Douglas Stuart Harned
Bernstein Institutional Services LLC, Research Division

And then still a big program for you is F-35 production. We're looking at that staying pretty flat at 156 for next several years, probably. When you look at your work, presumably, the production part is pretty flat. But do you see growth there when you look at upgrades? I mean, Block 4 has been pushed out. So how does that -- is that a flat program? Or are you getting enough sustainment work to...

Kathy J. Warden
Chair, CEO & President

It's a modest growth program because we are -- in our aeronautics business, we do the production of the center fuselage and some other ancillary support to the production program, but we also are growing the sustainment footprint, which is executed out of that business. In our Mission Systems business, we are supporting the Block 4 modernization. And so as part of that, we are seeing growth both to develop the next-generation systems and then as those transition into production.

Douglas Stuart Harned
Bernstein Institutional Services LLC, Research Division

Okay. Now you have a new unmanned entry, your CCA entry. Earlier, we heard Anduril here. They talked about their CCA entry. Tell us about this, how you've competed on it? GA and Anduril got the first 2 increment ones and then now you've got a third, but help us understand this.

Kathy J. Warden
Chair, CEO & President

So look, we didn't do the investment with the intention of getting a CCA award. We did the investment to do two things. One, we know that the marketplace for combat collaborative aircraft is going to require a next generation of autonomy, and we had over 500,000 flying hours on autonomous vehicles between the Global Hawk, the Triton and other programs. And all of that experience allows us to build vehicle management systems, but also to create testbeds. And so we did that with something called Talon IQ. It is a manned aircraft, but it is a flying testbed basically for us to continue to advance autonomy.

And we have invited partners in to fly on that testbed and utilize their autonomy systems because if they have a more affordable or on point solution, we want to be able to embrace partners in that regard. So that was one part of the investment. The one that you're asking about is Talon Blue. That's actually the aircraft that we're building. It is an unmanned aircraft. And what we wanted to do was two things. Set out to show ourselves that we could build an autonomous aircraft at a much lower price point that still had a high level of mission capability.

And so we did that with a focus on the time line to design and build, with a focus on manufacturing processes and using more tech automation in the manufacturing process to shorten that cycle and to reduce things like part count that reduce complexity out of the aircraft. And we have met our objectives in that regard and ended up with an aircraft. And when we showed the Air Force, what we had done on our investments and where we were headed, they were impressed with what we had done and gave us a designator that allows us to fly that aircraft and test it on their ranges.

We are -- the YFQ-48A, and so our aircraft now will be able to demonstrate these capabilities. It will eventually lead us to market offerings for the Air Force, the Navy, the Army, the Marine Corps, international partners. Whether it's selected as the Air Force CCA, it was never our intent. Our intent was to create a product line because we believe this market has continued to evolve, and we want a mission-capable affordable option to offer. And so that's what we're doing.

Douglas Stuart Harned
Bernstein Institutional Services LLC, Research Division

Well, if I go back a couple of years and you look at the Aeronautics business, you had a number of mature programs that were declining and you -- we just -- the B-21 was starting to grow. Are we past all that? Are we at the point where we should expect good growth going forward and...

Kathy J. Warden
Chair, CEO & President

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Yes. Any new technology area is met with wild enthusiasm at the beginning and then systems are fielded and there is a learning curve. And in this case, it's a user learning curve because we have very capable autonomous aircraft. But when a pilot sees that is displacing them or has to figure out what is the concept of operation for this aircraft, there is a learning curve that happens. And we have been on that journey with the services. We know what that looks like.

But to your point, I do think we are emerging out of that period where there will be more widespread adoption. That's why we're very serious about this market and continuing to play in it. We're not going to run the table. We're not going to be the only game in town. No one is. So this market, as it becomes bigger and more relevant, it's going to have multiple players, and we want to position Northrop to be one of them.

Douglas Stuart Harned
Bernstein Institutional Services LLC, Research Division

So if you look at margins now for aeronautics, you're kind of looking at kind of a 9%-ish type rate. Can that get up to 10%? And then you have the overhang of the B-21, but what's the potential to bring that up to 10% over the next few years?

Kathy J. Warden
Chair, CEO & President

We've been clear that AS can attain 10% margins and really two things need to happen. One is B-21 continue to progress on its current schedule for transitioning out of low rate initial production and into full rate production. And as that happens, margins will naturally improve. And the development mix, things like TACAMO also progressing into production. We'll put that portfolio back to where it has historically been, which is fixed price production being the heavy mix that has those higher margins.

Now of course, if we are to win another large development program, that would be -- it's something we would absolutely embrace. It would put some pressure on how quickly we get back to 10% because those do tend to have development margins, high single digits. But at the same time, we do expect that just B-21 and the mix alone there will transition us closer to that 10% mark.

Douglas Stuart Harned
Bernstein Institutional Services LLC, Research Division

Well, speaking of new development programs, F/A-XX, can you give us any insight into what's going on there? We've seen a lot of talk over the last several years and some money.

Kathy J. Warden
Chair, CEO & President

Yes. So the program was funded by the Congress in the FY '26 budget, and there is money in reconciliation. So there is funding for the government to proceed. And we most recently heard from Secretary Hegseth testifying before the HASC that there is support for the program to proceed and suggesting that an award would likely be done by the end of August. So that is the latest word from the department on the program.

Douglas Stuart Harned
Bernstein Institutional Services LLC, Research Division

So we may hear something in a couple of months. So let's go to Defense Systems, Sentinel. This has gone through a complex birthing history in a sense. Can you talk about where things stand today in terms of when IOC will happen, the Air Force's plan, how you're performing? There are so many pieces to this puzzle. Maybe you can help us with this.

Kathy J. Warden
Chair, CEO & President

This is another really positive step from where we were a year ago to where we are today on the program. The Air Force has designated a direct reporting program manager, General Dale White, who has come in and really worked with us and the Air Force team to establish a baseline that allows us to pull the schedule on the program earlier from what was established in the review just a couple of years ago and we are targeting cost reductions from that baseline coming out of the 2024 review.

These are really positive steps that are being obviously well received by all stakeholders. We are also performing well on the program. So we have achieved our milestones quarter-over-quarter, and that's been recognized by the Air Force as really solid industry team performance. We have built all the components of the missile and tested them individually. Now we'll be bringing that together in the

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full missile design, development and test program. We are going to be pad launching the first missile in 2027, which is earlier than we had anticipated.

And we have all aspects of the program moving at pace, including a prototype that we are building for the launch facilities, which is one of the key developmental areas of the program. So really pleased with how that team is performing. It's early innings. It's a complex development program. General White and I and the team have all eyes on to make sure that this important national security capability is fielded on our new schedule and costs, which will be finalized by the end of the year. That's when we reach what's called Milestone B.

Douglas Stuart Harned
Bernstein Institutional Services LLC, Research Division

Now also in Defense Systems, so you're one of the leaders in solid rocket motors. How are you seeing the growth right now from -- on your existing platforms?

Kathy J. Warden
Chair, CEO & President

So we are both a tactical missile prime on a couple of programs, AARGM-ER and Stand-In Attack Weapon. Those are coming out of development. AARGM-ER, we've just delivered our first two low rate initial production units, and we will continue to scale that program. Stand-In Attack Weapon will go into testing next year and then into production. But as you said, the vast majority of our contribution to the tactical missile market is as a supplier. And we are a supplier on everything from nozzles to casings to seekers but solid rocket motors are often the component most talked about because of the need for more capacity.

We set out several years ago, invested Northrop Grumman funds to build that capacity with the anticipation of an opportunity to get qualified as a second source on many tactical missiles where we were not the current provider, including PAC-3. And we have recently signed an agreement with Lockheed Martin. I think Jim was on the stage talking about that yesterday, and we are near finally qualifying on that weapon. We are doing the same on other weapons so that we can offer this capacity that we have built to the primes and to the government to facilitate the acceleration that they are planning for 8 or 9 missile types.

Douglas Stuart Harned
Bernstein Institutional Services LLC, Research Division

I mean what -- so we've heard the discussions on missiles, the frameworks that Lockheed has been working through with the Pentagon on PAC-3, on THAAD, Raytheon, similarly on a whole set of programs, SM-3 and others. So when you look at those efforts, which are going to triple or quadruple production, how do you look at your growth as a key supporter for those programs and [indiscernible] included?

Kathy J. Warden
Chair, CEO & President

Well, that business has been our fast -- yes, it's been our fastest growing double-digit growth. We expect that to continue at least teens, if not into the 20s. And we are experiencing that growth on all dimensions, as I said. We are a supplier and where we're prime and the programs are transitioning into production or getting qualified. So that growth is all ahead of us. I would also say that's tactical missiles, our munitions business is also growing very rapidly, both U.S. and domestic and there we are a prime provider.

So we are seeing our Defense Systems business grow double digit and expect that to continue for the foreseeable future fueled largely by this munitions demand.

Douglas Stuart Harned
Bernstein Institutional Services LLC, Research Division

Well, in munitions, you mentioned export, my impression was that, say, Europe now was trying to do more in Europe than by U.S. Where is your export munitions demand coming from?

Kathy J. Warden
Chair, CEO & President

It's really broad-based. We aren't seeing it only come from Europe, but we are still supplying to Europe despite the dynamic that you just outlined. We are also doing co-production in Europe, which satisfies that desire for some local content, but they are building to our designs. We are absolutely seeing the Middle East expand as a market with higher urgency as well, particularly in the recent

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months due to the Iran conflict and a desire to fast-track those export approvals and get capability, not just munitions, but homeland defense capabilities like our IBCS offering, which also sits inside of our Defense Systems portfolio.

Douglas Stuart Harned
Bernstein Institutional Services LLC, Research Division

Yes. On IBCS, you've talked about some very large dollar amounts of opportunities like $10 billion or something like that in terms of export. Where are you on that path, I guess, in terms of growing that business? How big can it be?

Kathy J. Warden
Chair, CEO & President

Right, still see very robust demand internationally, and we are now in full rate production for the U.S. Army. So we are fielding those systems as well and it is materializing as quickly as we have expanded the capacity to produce. So there too, we are running at full capacity in production. We have about a dozen nations that have submitted requests to the U.S. Army for export of that capability to them. We are already fielding in Poland.

We have been involved in some live fire exercises demonstrating the capability all across Europe, which is driving more demand. And as I said, we have 3 nations in the Middle East who have requested urgent capability response for it to be deployed there as well.

Douglas Stuart Harned
Bernstein Institutional Services LLC, Research Division

And also, this can play into Golden Dome. How does it fit into the Golden Dome?

Kathy J. Warden
Chair, CEO & President

It fits nicely into the Golden Dome architecture as a short mid-range defense solution, and it can address any type of inbound threat. So it can track drones, missiles and it's going to pair what the threat is with the appropriate effector. So as we were talking earlier about this sensing a threat and pairing the appropriate response, both appropriate in terms of probability of intercept but also cost profile, a system like IBCS can -- has that intelligence built into it that can help that happen real time. So you only have seconds to determine what to field in response to an incoming drone or missile and the automation that IBCS provides allows that to happen.

Douglas Stuart Harned
Bernstein Institutional Services LLC, Research Division

Now, if we go over to Space, so Space, you went through a little bit of a valley there with the cancellation of the classified contract. You did not win NGI. Now as you come out of that space, it's a high priority in this budget. It's probably going to be a high priority in almost every budget. The people I talk to, say, if we see any major conflict happen, it's going to start with cyber and space. So how would you characterize your growth opportunities in the Space business today?

Kathy J. Warden
Chair, CEO & President

The space market is very robust. And after 5 years, where we doubled the Space business, as you said, we had a valley with the pressure that those two programs that you noted put on the portfolio. We have those behind us as of the first quarter, which was the last quarter of year-over-year compared with the programs in our revenue profile, and we expect accelerating growth in the segment, as a result, the U.S. budgets for space are exceptionally strong over the newly released FYDP and our portfolio is well positioned to be responsive to those opportunities. So expect us to be back on a mid-single-digit or better growth trajectory for space going into next year.

Douglas Stuart Harned
Bernstein Institutional Services LLC, Research Division

Well in that, a couple of programs. Well, let me first say it's also important for Golden Dome, right?

Kathy J. Warden
Chair, CEO & President

Yes.

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Douglas Stuart Harned
Bernstein Institutional Services LLC, Research Division

And how does it fit in there? I'm assuming space-based interceptors is a part.

Kathy J. Warden
Chair, CEO & President

Yes. Certainly, the government has released information about pursuing a team for C2 to support Golden Dome that we are on. They have shared that they've selected teams, including Northrop Grumman, to build space-based interceptors but also just broadly, the missile tracking and missile warning capabilities we are providing through the Space Development Agency, that creates an architecture, our Next-Gen Polar solution, which is missile tracking and missile warning for the polar region of the world. These capabilities will all contribute to that Golden Dome architecture.

Douglas Stuart Harned
Bernstein Institutional Services LLC, Research Division

And some of the things that are, again, related -- so many things relate to Golden Dome, so it's kind of hard to separate all this out. But we go to a couple of programs. So HBTSS, can you talk about where that stands? It's a critical program, hypersonic tracking system, so.

Kathy J. Warden
Chair, CEO & President

Yes. So we were involved in the contract to prototype a system that we fielded and have the learning carried forward that we are incorporating into other solutions that now are being bid as part of different contract types and architectures. So we are still very much involved in that missile tracking missile warning and supportive of identifying and tracking hypersonic but HBTSS and its prior configuration isn't the way we're taking that capability forward.

Douglas Stuart Harned
Bernstein Institutional Services LLC, Research Division

Okay. And then on the SDA tracking layer, so you're in Tranche 3, you were not in Tranche 2, you were in Tranche 1, Tranche 3. I mean how does that all work? How do...

Kathy J. Warden
Chair, CEO & President

Every tranche has different requirements. And so we look at how competitive we are. And sometimes we bid, sometimes we don't, sometimes we win, sometimes we don't. But our overall track record across the 3 tranches, so for transport and tracking layer, we've been successful to the tune of 150 satellites in backlog. So we feel really good about how we're positioned relative not only to the competition, but where we have won, what we're developing and the positioning that gives us for future tranches.

Because to your earlier point, these satellites are built with shorter expected life and will need to be replenished over time. They will continue to be upgraded as the threat environment progresses and so we're pleased to be operating both in transport and tracking and to have this many satellites in backlog that give us scale to continue to be competitive.

Douglas Stuart Harned
Bernstein Institutional Services LLC, Research Division

Well, how -- so can you help us understand how this is all going to eventually play out? Because we've got 150 satellites here. On the traditional side, Lockheed Martin, L3 Harris, they've also got quite a bit, then you've got new players like Sierra and Rocket Lab, and they've got satellites. What is the end game here? What is this going to look like? How is this capability sort of shared? And how do you differentiate yourself?

Kathy J. Warden
Chair, CEO & President

Yes. With each tranche, there are new requirements. And so we differentiate ourselves on technical capability, just like we do any other area of our business, and we need to be able to offer that at a competitive price point so that we can ultimately win. But that trade of what you're providing and value is what the cost reflects and we've been able to successfully do that. I think the end game

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doesn't look very different than it is today. The government is going to want an ecosystem of players. We're each going to prioritize certain areas where we're more or less competitive.

So it will be different companies that win on different tranches. But at the end of the day, a healthy, robust industrial base with multiple companies that can come to these competitions and prevail and have good business cases that deliver return to our shareholders is the desired end game by industry and the customer.

Douglas Stuart Harned
Bernstein Institutional Services LLC, Research Division

But is -- and this is just my personal challenge in understanding it. But you'll end up with a constellation up there. And you've got a lot of different contractors. Isn't there ultimately some scale advantage if someone can provide a capability? Are you -- or does it turn out to be more a build-to-print operation? I mean I'm trying to picture how you have all of these varied companies all participating.

Kathy J. Warden
Chair, CEO & President

I mean, clearly, there's a scale advantage, but there's also an advantage to having a competitive and resilient ecosystem. And so the government wants both and they will have a balanced approach to get both. And that's no different than if you think about the air domain. There are a lot of different aircraft up there built by different people. The government still can use them in a coordinated fashion and conduct missions. And I think that's the way the space force is looking at it as well.

Douglas Stuart Harned
Bernstein Institutional Services LLC, Research Division

Okay. And do you see any difference when you're competing in these against the new entrants versus your traditional peers?

Kathy J. Warden
Chair, CEO & President

No, not really. It's very much about, as I said, the technical cost trade-off as it should be. And the new entrants have to be able to do that just like the large companies, and we keep each other honest, right, in terms of bidding to what we can actually perform. And I think that's the challenge that the government has always had and will continue to have separating the wheat from the chaff in terms of what companies can actually deliver and which can't and that we all have to prove ourselves every day.

Douglas Stuart Harned
Bernstein Institutional Services LLC, Research Division

So if we jump over to Mission Systems. This is a business that is absolutely impossible to model. So you got many, many programs in there. But I know it's also one that you have stressed is really differentiated. Could you talk about that differentiation and how we in this room should think about what the growth trajectory would be for that?

Kathy J. Warden
Chair, CEO & President

Yes. Highly diversified business, most profitable business in our company, and it's because of the very capable technology that is fueling systems in every domain, space, air, land, sea, subsurface. And those systems at their core are microelectronics that are used in radars, electronic warfare, communications, and it's really about the power of the very small micro processing that we build in our foundries in that business. I'd love to get the multiples that chip companies are getting right now because we basically are doing the same thing, but for government application.

In many ways, we look at that business as the fuel for differentiation of these large platforms, both ones that we build and other companies build by giving them an advantage in seeing further, detecting faster, jamming other systems. This really often is the asymmetric advantage that our military has. It's through the mission systems that we're providing.

Douglas Stuart Harned
Bernstein Institutional Services LLC, Research Division

Should we think of this as kind of a mid-single-digit growth business? Is it...

Kathy J. Warden
Chair, CEO & President

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Yes. Last year, it was more like 10%. This year, we're expecting it to be a little below, mid-single digit. But if you look over the last 5 years, this business has consistently been in that mid-single-digit range with this environment being very opportunity-rich, we expect it to be at least mid-single digits next year.

Douglas Stuart Harned
Bernstein Institutional Services LLC, Research Division

In Q1, you had 15% margins, which is a little better than normal. Can you do that sustainably 15%?

Kathy J. Warden
Chair, CEO & President

Absolutely. This business has performed at that level before. We've had a good bit of development work in the business, which is great because that means we're fueling production growth into the future. As that mix shifts more toward production, it provides tailwinds to margin and that's some of what you're seeing in that business. Our cost-plus development work is starting to creep down a little. Our fixed price development going up and that's going to continue to provide margin tailwinds to support that 15%.

Douglas Stuart Harned
Bernstein Institutional Services LLC, Research Division

So if we put all this together, can you update us on your free cash flow outlook?

Kathy J. Warden
Chair, CEO & President

Yes. So I know this is an area that [indiscernible] are trying to model. So coming out of our first quarter, we framed the investments that we're making in the B-21. We updated our CapEx projection this year and added about $200 million, but we kept our free cash flow guidance intact. That's important to note. So even though we have committed to spend more in 2026, we did not come off of our free cash flow guidance for the year. As we look out over '27 and '28, these increased investments due to both B-21 and this opportunity-rich environment that we've talked to you about, we expect CapEx as a percent of revenue to be around 4.5%.

We are continuing to see strong growth in our operating cash as a result of top line growth, good margin performance, the margin tailwinds that we've talked about, as we look out over the next couple of years, very strong cash generation in this business with a slight uptick in what we are expecting to spend in CapEx, still very solid free cash flow, and we will update you on specific free cash flow guidance later in the year, as we always do, for 2027. But for '27 and '28, CapEx you can model about 4.5% of revenue, which is just a slight tick up from where we are this year.

Douglas Stuart Harned
Bernstein Institutional Services LLC, Research Division

This includes the B21?

Kathy J. Warden
Chair, CEO & President

It includes the B21. It includes the munitions acceleration. It includes what we have framed supporting the growth that we've committed to the department.

Douglas Stuart Harned
Bernstein Institutional Services LLC, Research Division

And does that -- if we look kind of out into the future, should we think of this as a period of investment where if we go out 4 or 5 years, I mean other things may come up and you'll invest in that. But right now, is it -- this is sort of an unusual bump up for a few years and then that may moderate unless something else comes along.

Kathy J. Warden
Chair, CEO & President

Right. We have found ourselves in the position of a very opportunity-rich environment, which we have translated into nice growth in this business. And so we see the opportunity to continue to smartly invest in the business to generate that profitable growth. Great setup in this company as you look out into the 2030s with B-21, Sentinel transitioning into production. Many of the smaller programs that we've talked about in space and microelectronics and certainly, the munitions ramp that we talked about, fueling defense systems.

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We are sitting on a tremendous set of growth opportunities. We want to invest in the capacity to deliver on those to accelerate in some cases like B-21, the realization of those sales and margins. This is all positive for our investors. And we still see the ability to do that with about 4.5% of our revenues invested back into CapEx. We think this is a really good setup for our shareholders. And it certainly leans into what we've committed to our customers, which is making sure we're investing in our business to supply their needs.

Douglas Stuart Harned
Bernstein Institutional Services LLC, Research Division

And anything you can say on cash deployment beyond the CapEx?

Kathy J. Warden
Chair, CEO & President

Yes. Our capital deployment strategy remains the same. We first are going to prioritize the investment to be responsive to the department, and we've done that. And in many ways, we were ahead of our peers investing at a higher rate so that we have capacity that we're bringing online now. And our customers are thanking us for that for having the commitment and the foresight to do these investments so that we have the capacity in place and we can commit to accelerated deliveries. And we are proud of having done that. We see the whole industry moving in that direction now, and we are going to continue to have that be our top priority.

We are also committed to paying a competitive dividend. Our Board just increased our dividend 7%, which is in line with our operating cash increase year-over-year. And we will continue to look at returning cash to shareholders, if we don't have better uses for it, with high return opportunities in response to our customers' needs.

Douglas Stuart Harned
Bernstein Institutional Services LLC, Research Division

Well, great. Well, I think we're out of time here, but Kathy, thank you very much.

Kathy J. Warden
Chair, CEO & President
Thank you.

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