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Presentation

Operator

Good day, ladies and gentlemen, and welcome to Northrop Grumman's First Quarter 2026 Conference Call. Today's call is being recorded. My name is Josh, and I will be your operator today. [Operator Instructions]

I would now like to turn the call over to your host, Mr. Todd Ernst, Vice President, Investor Relations. Mr. Ernst, please proceed.

Todd B. Ernst

Vice President, Investor Relations

Good morning, and welcome to Northrop Grumman's First Quarter 2026 Conference Call. Before we start, matters discussed on today's call, including guidance and outlooks for 2026 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. In addition, we will refer to a presentation that is posted to our Investors Relations website. On today's call are Kathy Warden, our Chair, CEO and President, and John Greene, our CFO.

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

Kathy J. Warden

Chair, CEO & President

Thanks, Todd. Good morning, everyone, and thanks for joining us today. The Northrop Grumman team is proud of the work we do in support of the world's most important national security imperatives. As we are seeing in recent military operations, many of our systems are playing a critical role in successfully executing the mission and returning our service members home safely. We contribute enduring assets like the B-2 Stealth Bomber and the E-2D, which continue to demonstrate tremendous value decades after their first flights. Our ISR and C2 systems provide the needed intelligence to plan and conduct successful operations across all domains, and our munitions are instrumental to execute these missions.

We share in the responsibility and urgency of our customers to provide our nation and allies with the best technologies in the world, and we are increasingly focused on the speed with which we deliver them. With this goal in mind, we've been investing in our business for several years to build capability and capacity, and provide the solutions at the scale our customers need to compete in this environment. In fact, in the last 2 years, we've opened over 20 new facilities and added more than 2 million square feet of manufacturing space across the United States.

Since the beginning of 2026, we have agreed with our customers on plans to accelerate the Sentinel program, increase the rate at which we build the B-21, become a second source supplier of solid rocket motors on several programs and ramp our rate of production on another handful of programs. And we're just getting started. We are in discussions on numerous additional opportunities to help achieve the department's goal for speed and scale.

Central to all these agreements is our partnership with our customers as we transform the way we work together. Our teams are aligned in unprecedented ways to deliver on our commitments and enable our armed forces to win.

Earlier this morning, we released our first quarter results, which reflects strong demand, solid operating performance and progress we are making on key programs. First quarter organic sales were up 5%, a great start to the year and consistent with our full year expectations. Sales were largely driven by growth in our work on modernizing the Triad, which is a top priority in the U.S. National Defense Strategy. We had another quarter of solid bookings, reinforcing the foundation for continued growth over the coming quarters and into next year. Our results and our confidence in our outlook are supported by a robust demand environment driven by rising global defense budgets.

Countries around the world are recognizing a fundamental shift in the geopolitical environment, leading to global military spending rising approximately 40% over the past decade, and it's expected to continue to rise as Western nations modernize and grow their forces. In the Middle East, particularly, there is a heightened sense of urgency for our solutions such as IBCS, G/ATOR and counter

UAS solutions. In the U.S., \$1 trillion has been appropriated for defense in fiscal year 2026 and funding from this budget and reconciliation are starting to flow to industry.

Earlier this month, the administration submitted a \$1.5 trillion defense budget request for fiscal year 2027. The budget emphasizes modernization and represents a 44% increase over current funding levels. The budget proposal is made up of several components with a base budget of \$1.1 trillion. The base budget alone compared with the FY '26 base budget represents nearly a 30% increase, and it sustained support for many of our key programs including B-21, Sentinel, IBCS, E-2D and numerous restricted programs.

If enacted, the budget request for 2027 would bring spending to about 5% of GDP. And while this represents an increase to the 3% we've seen in recent years, it's closer to the levels we saw during the Cold War. We are encouraged by the strong bipartisan support for strengthening U.S. defense budgets, aligned to the global security challenges we are facing, and we look forward to working with policymakers as they consider this budget request.

In response to these high levels of global demand for our solutions, the administration is working closely with industry to provide clear long-term demand signals through structured production frameworks. So let me share details of some of the agreements I referenced earlier in the call.

Our Defense Systems business growth is fueled by the growing demand for solid rocket motors, smart munitions, ammunition and tactical missiles. We are a key SRM supplier on more than 15 systems, including GMLRS, PRSM, Hellfire and AIM-9X among others. And we are taking the necessary steps to qualify as a supplier on other high-demand systems such as PAC-3.

To position the company for this growing market, we invested more than \$2 billion over the past several years in SRM and munition technologies and in modernizing our facilities. This proactive approach established a strong U.S. manufacturing base with capacity available today to support our customers' growing demand for critical munitions. Our tactical SRM production capacity has already doubled, and we have further expansion, which will be completed by 2027.

These modern production facilities provide us modular, adaptable production lines that can produce multiple products, allowing us to flex with demand. Overall, our weapons business is nearing 10% of total company sales and is positioned to grow at a pace well above the company average.

In addition to a focus on munitions, we and the Department of War remain committed to accelerating the Triad modernization. For Sentinel, we are working closely with the Air Force and making significant progress, advancing missile development, command and control systems and maturing the design and construction approach. In March, we broke ground on a prototype of the Sentinel launch Silo tube, which will validate the structural design and construction approach, a key enabler to accelerate fielding. We expect to reach the Milestone B decision later this year, first flight in 2027 and initial operating capability in the early 2030s. We expect strong growth from Sentinel throughout the year as we ramp up on the new baseline with the program already delivering double-digit growth in the first quarter.

On the B-21 program, we are moving through testing at an aggressive pace, including aerial refueling trials beginning earlier this month. We are on a path through both testing and production for B-21 to arrive at Ellsworth Air Force Base in 2027. Consistent with this progress, we received the Lot 4 LRIP award in the first quarter, closely following the Lot 3 award received in Q4 last year.

As previously announced, we finalized an agreement with the Air Force to increase the annual production rate of the B-21 by 25%. This agreement demonstrates the strong operational requirements for the platform and confidence in our team to accelerate the delivery of this next-generation capability for the war fighter. The production ramp-up will be supported by customer funding included in last year's reconciliation package, alongside approximately \$2.5 billion of company-funded investment, primarily for new facilities. These investments will be phased in over multiple years. Importantly, this agreement accelerates production for our customer, enhances the program's long-term economics and creates the potential for a larger program of record. We're pleased to have this agreement in place and excited for this transformative technology to begin arriving on Air Force bases next year.

In another area of our portfolio, widespread adoption of ballistic missiles and drones by potential adversaries are reinforcing the urgent need for air and missile defense capabilities. Demand in this area has been exceptionally strong. And today, our missile defense business accounts for nearly 10% of company sales. Northrop Grumman is well positioned to capitalize on significant opportunities such as Golden Dome as well as other program areas. Our advanced interceptors, sensor systems and command and control technologies remain critical to strengthening layered defense architectures.

Shortly after the close of the quarter, we secured an award to accelerate development of the Glide Phase Interceptor, bringing the total contract value to \$1.3 billion. GPI is designed to intercept hypersonic missiles that can evade traditional missile defense systems, a critical capability given the proliferation of hypersonic weapons.

Before concluding, I'd like to highlight our role in the historic Artemis II launch. It's a reflection of the diversity of our space business, which extends across a wide range of missions. Two Northrop Grumman built solid rocket motors generated an astounding 7.2 million pounds of thrust, over 75% of the rocket's total thrust, to propel the SLS rocket and the astronauts on their journey around the moon. We are incredibly proud of our team, and I'd like to congratulate NASA and the Artemis II crew on a successful mission.

In summary, we continue to see an opportunity-rich environment. Our investments in our business, rigor and program execution and speed with which we are bringing innovative solutions to our customers gives us confidence in our position today and into the next decade. When coupled with our strong backlog and unprecedented opportunity set, we're optimistic we can continue growing our business and creating value for all of our stakeholders.

I'll now ask John to cover our first quarter financial results. John?

John Thomas Greene
Corporate VP & CFO

Thank you, Kathy, and good morning, everyone. I'll start with our first quarter segment results on Slide 4. We continue to experience robust demand for our products and capabilities. Awards totaled \$9.8 billion in Q1, and we ended the period with \$96 billion in backlog. First quarter sales were \$9.9 billion, up 4% year-over-year. Organic sales increased 5%. On the bottom line, segment operating income increased to over \$1 billion and segment margins improved to 10.8%.

First quarter results were driven by higher sales and improved performance in Aeronautics Systems. AS sales increased by 17%, driven by higher sales on B-21 and other restricted programs. TACAMO sales were also higher as the program continues to ramp. Higher sales on B-21 reflected the inclusion of the agreement with the Air Force to expand production capacity, which I'll address in a moment. The sales increases were partially offset by lower volume on F/A-18.

On the bottom line, first quarter AS operating margins improved to 9.3%. The increase was driven by the absence of the B-21 loss provision booked in the first quarter of 2025. As Kathy mentioned, we are pleased to have an agreement in place to increase the production rate on the B-21 program. To support the acceleration of aircraft deliveries, we agreed to sell an aircraft to the Air Force that was previously planned to be utilized as a company-owned test asset. The asset sale accelerated revenue into the quarter, but does not change the total number of aircraft we expect to deliver on the LRIP phase of the program.

Additionally, after reviewing our profitability estimates on the LRIP phase of the program, which now includes the agreement, there were no significant changes to the EAC. We had some increased production costs on earlier lots, which were offset by improved profitability on the remainder of the program. With the agreement in place, we are accelerating the program and have an opportunity to earn improved returns over a multiyear period.

Moving to DS. Q1 sales increased 5% year-over-year. Organic sales increased 10%. This was driven by higher volume on Sentinel as the program continues to ramp. Sales were also higher due to increased volume on tactical solid rocket motors and Integrated Battle Command programs. First quarter operating margins at DS were solid at 9.7%.

Mission Systems first quarter sales increased by 2%, driven by increased volume on restricted airborne radar and marine programs. These increases were partially offset by lower volume on SABR and electronic warfare programs. MS operating income increased by 20%, driven by a higher level of net favorable earnings adjustments. This increased their first quarter OM rate to 15.1%.

In the Space segment, first quarter sales and operating income were down compared to the prior year. This was driven by two factors: first, the NGI program recognized \$98 million in the first quarter sales last year as part of the contract closeout. This created a year-over-year headwind in Q1 this year. Secondly, we recognized an unfavorable earnings adjustment of \$71 million on the GEM 63XL program. This adjustment lowered sales and operating income in the period. Performance elsewhere in the space portfolio was strong with growth on SDA programs and restricted space.

Turning to earnings per share on Slide 5. First quarter diluted EPS was \$6.14, up substantially compared to the prior year. This was driven by higher sales and segment operating income, partially offset by lower net pension income. In terms of cash flow, the first quarter reflected a use of approximately \$1.8 billion, in line with the prior year. Consistent with our historical patterns, we expect cash flows to ramp throughout the year with the most significant cash generation in Q4. We expect CapEx to follow the same pattern as we continue to invest to support the strong demand environment and our future growth.

As I indicated on the fourth quarter call, we repaid \$527 million of fixed rate debt in Q1. We ended the quarter with over \$2 billion of cash on the balance sheet.

Turning to our 2026 guidance. We are reaffirming our outlook for sales, earnings and cash. We ended the first quarter with positive momentum and continue to expect full year results within the existing guidance ranges. This includes full year sales between \$43.5 billion and \$44 billion. We continue to expect sales to accelerate throughout the year, similar to the cadence in 2025. For the second quarter, we expect high single-digit sequential sales growth. And for the full year, we continue to expect broad-based sales growth across the portfolio.

Segment operating income guidance reflects continued strong performance and a low to mid-11% margin rate. Margins are expected to improve over the course of the year, driven by strong performance, production timing and mix. Our capital deployment strategy remains focused on driving growth, reinvesting in the business to scale capacity and maximizing shareholder value. This includes an additional \$200 million we expect to invest this year to support the increased production capacity on B-21. As a result, we now expect \$1.85 billion in 2026 capital expenditures. However, we are maintaining the free cash flow guidance range of \$3.1 billion to \$3.5 billion. Given the increased capital investments, we are working to offset the free cash flow impacts.

To summarize, we continue to generate strong financial results. I'm confident that we are well positioned for continued profitable growth and value creation.

Before we open the call for questions, I'd like to take a moment to congratulate Todd on his upcoming retirement at the end of this month. We appreciate his contribution over the past 7 years. Todd has been a highly valued team member and a trusted business partner. We wish him well as he embarks on the next chapter.

With that, let's open the call for your questions.

Question and Answer

Operator

[Operator Instructions] Our first question comes from Robert Stallard with Vertical Research.

Robert Alan Stallard
Vertical Research Partners, LLC

First of all, thanks, Todd, for all your help over the years, very much appreciated. And then second, on the B-21, Kathy, you've got this 25% production capacity situation sorted out now. I was wondering if you could give us some idea of how the time line progresses here in terms of Northrop Grumman spending on CapEx and how the production flows through? And also, if you've got protections in here against a B-2 style curtailment?

Kathy J. Warden
Chair, CEO & President

Yes, Rob. So we expect \$200 million or so of CapEx this year, and that's why we reflected that increase in our CapEx guidance for 2026. As we've said before, we do expect the majority of the capital expenditure to happen in the '27, '28, '29 time frame and largely be completed this decade. The additional capacity that's coming online does give us a meaningful increase in throughput, which will generate revenue over the life of the program. But as I've just stated, it takes a while for us to get that capacity online. So you should expect the revenue profile to follow the production facility completion.

Robert Alan Stallard
Vertical Research Partners, LLC

And on the B-2 -- sorry, why it's not like the B-2?

Kathy J. Warden
Chair, CEO & President

Why it's not like the B-2? In terms of this contract, we have a committed quantity on the contract, and we know that the Air Force is considering increasing the program of record as we sit here today. That decision hasn't been taken. But we do believe that there is strong support by the administration for this capability that manifests itself in their commitment to the Triad modernization in the U.S. National Defense Strategy. And we believe that it is a reflection, over multiple administrations, of the need for this platform as an effective deterrent and as we've seen recently with the B-2 in conducting its military operation.

Operator

Our next question comes from Gautam Khanna with TD Securities.

Gautam J. Khanna
TD Cowen, Research Division

Yes. I was just wondering if you could elaborate on some of the Sentinel developments that you mentioned on IOC and how that program is progressing with respect to timing? And congrats to Todd as well.

Kathy J. Warden
Chair, CEO & President

Thank you. So for the Sentinel program, in partnership with the Air Force in this past quarter, we have agreed to an acceleration of the program that would have completion of Milestone B later this year and then would allow us to move forward with the program, as I said, to first flight in 2027 and an initial operating capability early in the 2030s. We are doing a series of things together with the Air Force to enable the schedule acceleration. One, I mentioned that got started in the quarter is a prototype of the missiles launch silo and that will help us to understand and further increase the fidelity of our design for the silo itself. But that's just one example of numerous things that are happening across the program to mature the design and progress towards that first flight milestone that I talked about in 2027.

Operator

Our next question comes from Peter Arment with Baird.

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Peter J. Arment

Robert W. Baird & Co. Incorporated, Research Division

Congrats, Todd. Kathy, thanks for the color on international. Just maybe if we could just click on that a little bit. You're up 20% in 2025, just a lot has changed in the last few months. Can you talk a little bit about opportunities? Is there anything on international that can be pulled to the left? I know you're expecting a healthy book-to-bill of over 1 this year. Just any dynamics there that can accelerate the timing?

Kathy J. Warden

Chair, CEO & President

Peter, we see the opportunity to accelerate timing on international in areas where urgency has increased over the last couple of months. I specifically called out in my remarks, the Middle East, where clearly, the conflict with Iran has created a heightened sense of urgency, and we are seeing those opportunities move to the left. With that said, we see high demand for products that we produce across the entire globe, including Europe. And so our team is working in any ways possible to accelerate demand and turning that demand into sales.

What we see, though, is international does tend to have a longer cycle than domestic. That has not changed. Just in terms of the steps we must go through to get those -- that demand signal translated into contracts. So we are working with the department on a number of things that help to accelerate export approval. We are looking at aggregating international demand. Those are all positive steps forward in the way the process is working that could lead to acceleration. But I largely see those things impacting us beyond this year.

Peter J. Arment

Robert W. Baird & Co. Incorporated, Research Division

Got it. And just as a follow-up, you mentioned missile defense is roughly 10% of your overall revenue mix today. Can you talk a little bit about opportunities in the counter drone solution area? Obviously, we've seen a lot of focus on lower-cost solutions. How do we think about with Northrop's position there?

Kathy J. Warden

Chair, CEO & President

Yes. We have opportunities in the counter drone, including low-cost solutions that are based off of work we've been doing in that arena for a number of years, programs like our FAAD C2 program and even IBCS is effective in connecting sensors and shooters in that counter drone space. We have seen, as I have shared before, an increase in demand both from the U.S. and international. And so we expect the international contribution to be greater even than the domestic in counter UAS solutions. We see that developing over the next couple of years. We are already seeing some revenue today in that space. And as I noted, now nearly 10% of the company sales is in missile defense, which is a significant increase from where we were just a few years ago.

Operator

Our next question comes from Mariana Perez Mora with Bank of America.

Mariana Perez Mora

BofA Securities, Research Division

Congratulations, Todd. So my question is going to be around Space Systems. Apart from the GEM 63 impact, are there any programs that you could see at a kind of like negative EAC type of approach? And how that could affect the underlying margins for this segment going forward, particularly as we think about like what you just mentioned before, the strength on like missile defense and all the MDA programs, the GPI award you got, but also some changes at NASA on Gateway?

John Thomas Greene

Corporate VP & CFO

Mariana, thanks. This is John. I'll take that. So the Space sector is actually performing pretty darn well. The book-to-bill very, very strong, came in last year at about 1.3x and so that sets the business up for future sales. Now you do know that the cycle is a little longer in the Space business [Technical Difficulty]. In terms of kind of your specifics on the EAC, so we took a look at GEM 63, put our best estimate of what we thought the cost impact of that would be. And as we look through the rest of the portfolio, we were comfortable in the quarter that there wasn't anything else significant that gave rise to any significant negative or positive EACs.

So overall, we have strong margins, and the business was able -- it was actually able to close some of that pressure that GEM 63, EAC put onto the portfolio.

Mariana Perez Mora
BofA Securities, Research Division

Should we expect that margin strength to remain for the remainder of the year at Space? And how should we think about margin trends, I don't know, 3, 5 years from now?

John Thomas Greene
Corporate VP & CFO

Yes. So in terms of for the rest of the year, yes, we're comfortable with the position. As you noted, we didn't pull off the guide on margin, and that's because we feel like there's strength in the portfolio. As we look forward, that whole arena is evolving significantly. What I would say is, you take a look at the technology and the risk associated with it, over time, it should command a higher margin rate. But it will be subject to the competitive environment and capacity that's available.

Operator

Our next question comes from Kristine Liwag with Morgan Stanley.

Kristine T. Liwag
Morgan Stanley, Research Division

Todd, congrats on your retirement. So maybe a high-level question. Kathy, when you look at the backlog of \$96 billion, I mean, it's near record, providing sales coverage for over 2 years. And so mid-single-digit growth seems reasonable in a more normal environment. But in the past few years, you've called out there's urgency now in the geopolitical environment, and it seems like things continue to deteriorate. We're seeing the Pentagon seek out new players. And the White House had called out potentially firing up the Freedom's Forge in the auto industry to increase capacity. Can you talk and give more color about how you think about overall output for Northrop Grumman? Where are the areas of bottleneck? And what has to happen for the company to deliver on double-digit growth?

Kathy J. Warden
Chair, CEO & President

Sure, Kristine. So we are seeing an opportunity-rich environment, as I said. It's only the first quarter of 2026, and we now are just starting to see reconciliation dollars flow into our contracts. Our performance this quarter was in line with our full year guide of mid-single digit. But to your question, if we were to see a higher sales growth, it would come from our bidding on numerous new opportunities. We would expect to continue to see a high competitive win rate on those opportunities.

We'd also need to see an accelerated ramp on the demand for our missile components. I talked about solid rocket motors earlier on the call. We have the capacity. We need to get that on contract and start producing. We need to convert our international pipeline to sales, as I also referenced earlier in response to Peter's question, and our suppliers need to be able to scale with us. And we are doing the work to remove those bottlenecks in our supply chain first by identifying them, second by helping those suppliers to resource their own scaling and to have the capacity that we need from them.

So we're, of course, working on all of these strategies to increase our growth rate beyond the mid-single digits. I have a lot of confidence in our longer-term outlook for sales based on the growing backlog, as you've said, and the opportunity to add to that backlog this year. I think the real question is timing, when do we reach that inflection point, and it's based on all of the factors that I just shared with you.

Kristine T. Liwag
Morgan Stanley, Research Division

Super helpful. And if I could follow up on one of the programs that potentially could materialize this year. The Chief of Naval Operations said yesterday that, "One of the two companies vying for the F/A-XX contract lacks the capacity to deliver the fighter on time." So with the potential down select in August for this program, can you discuss how you're thinking about Northrop's positioning on this? And if you are selected, how should we think about the potential upside to 2026 outlook? And to your point on the funding for the program, is the funding for this program clear to provide upside potentially for 2026?

Kathy J. Warden

Chair, CEO & President

Yes. As you know, this is a good example of one of those competitive opportunities I just mentioned, and we do expect the department to make an award selection in the third quarter. We are confident in our ability to deliver our solution to the Navy. We and our suppliers are prepared to bring the workforce and infrastructure that's needed to execute the program and our track record on B-21 demonstrates that ability to deliver a complex aircraft on schedule.

Regarding the financials, we'd expect upside to the sales and earnings from our current guidance if we are entrusted to build the F/A-XX, and it would be a top priority for our company to do so.

Operator

Our next question comes from Sheila Kahyaoglu with Jefferies.

Sheila Karin Kahyaoglu
Jefferies LLC, Research Division

Thank you, Todd, for everything over the years. Kathy, in your prepared remarks, you gave us lots of color on the growth drivers of the missiles. You said missile defense is 10%, weapons at 10%. Can you maybe also size B-21 and Sentinel? And how do we think about these four growth drivers from both a revenue and earnings perspective?

Kathy J. Warden
Chair, CEO & President

Sure. Let me start with Sentinel. The program is about 6% to 7% of company revenue today, and we expect it to grow low double digits this year, which is in line with how it performed in the first quarter. We then expect it to continue to grow annually, so growing toward that 10% of revenue over time. The next real inflection point for the program is when we start to have long lead for production, which we expect later this decade.

For the B-21 program, it is nearing 10% of revenue. And with this accelerated production rate, we expect that it will likely, over the next several years, begin to exceed 10% of company revenue and certainly sets the program up for enduring growth as well.

Sheila Karin Kahyaoglu
Jefferies LLC, Research Division

Can you maybe talk about just the growth you expect in weapons and missile defense? How do we think about those and just the EBIT growth as well, if you can?

Kathy J. Warden
Chair, CEO & President

Yes. So for weapons, we have said we expect that to continue to be one of, if not the fastest-growing segment of our business. It is a set of opportunities that we have on the munitions where we are currently qualified to provide components like solid rocket motors. It's also our prime position as a weapons integrator that we expect to grow over time as programs like AARGM-ER and Stand-In Attack Weapon mature into production. And so that part of the portfolio today in aggregate is also about 10%, but we expect it to be one of the fastest growers, as I said, and proportionately become larger over these next several years. The growth rate will be somewhat dependent on how many new programs we add to the portfolio.

John Thomas Greene
Corporate VP & CFO

Maybe just a little more context on that. So most of that work is in our Defense Systems business, and you could see the guide that we provided at the beginning of this year in terms of the growth that we'll see there. So approaching 10%. And Sentinel, as Kathy said, about 6% of total sales, it's about 1/3 of the sales in the Defense Systems guide. So that will help you triangulate what we think the drivers are there and then also support the acceleration of potential growth into the future.

Kathy J. Warden
Chair, CEO & President

And Sheila, you also asked about margins. The margin profile on Sentinel, B-21 and our weapons portfolio are all expected to increase as we move into production because, as I stated, obviously, all of them are in various stages of development at the moment.

Operator

Our next question comes from Seth Seifman with JPMorgan.

Seth Michael Seifman

JPMorgan Chase & Co, Research Division

I wanted to ask on B-21 and the impact of the production agreement. I think you mentioned some pluses and minuses in terms of the estimate. I know you've noted before that the agreement could potentially lead to higher profitability on the LRIP units. Should we assume that, that higher profitability on the LRIP units and reversal of charges is something that's still a possibility depending on company performance over the next several years? Or should we be thinking about the increased profitability coming more on the NTE units and beyond?

John Thomas Greene

Corporate VP & CFO

Yes. So I'll take that one. So as you look at the program, first, the agreement we reached with the Air Force was a great outcome for both the company and the customer. As that agreement plays out, a portion of that, certainly a good portion will be subject to our execution on the LRIP phase. And based on how it came together, there was no meaningful change in the overall EAC. So there was some increased production costs that was offset with increased profitability in later phases of the program, so positive overall.

What we believe will be the case is as the program matures, our manufacturing capability will continue to improve, production rates certainly improve, and it gives us an opportunity to expand margins and hopefully sales with the increased rate of production.

Seth Michael Seifman

JPMorgan Chase & Co, Research Division

Okay. Great. Great. And then just as a follow-up, I guess, after this year, there's probably \$2 billion plus of incremental [B-21] CapEx over '27, '28, '29. When we think about the 2028 cash flow target, you're able to offset the impact of the incremental B-21 CapEx this year, but it's obviously in the future. How should we think about the ability to offset that?

John Thomas Greene

Corporate VP & CFO

Yes. So that's a substantial investment. So what we did do is, we guided and held our 2026 cash flow guidance. We intentionally didn't give guidance on '27 or '28 for two reasons: large awards outstanding that we're going to -- one of which we'll hear at the -- hopefully sometime in the third quarter. And then also the investment we're making, the \$2.5 billion investment we're making, that will play out. The lion's share of that will be in '27 and '28. So as we roll things forward, we'll take a look at what the free cash flow looks like. But not to be lost on the audience is the cash generation power of this business, and it will continue to generate substantial free cash flows and the investment will be subject to the opportunities we see.

Operator

Our next question comes from Richard Safran with Seaport Research Partners.

Richard Tobie Safran

Seaport Research Partners

Todd, congrats to you. This question, it could be for either for Kathy or John. Could you talk generally about the contracting environment overall? I'm wondering if you're seeing more favorable environment. Specifically, are you seeing, for example, contracts or revised contract language with award or incentive fees or other incentives for good execution? And if so, I'm wondering what -- if you could talk a little bit about what you think that might mean for margins and cash?

Kathy J. Warden

Chair, CEO & President

Rich, we are seeing the department engage with industry in several positive ways. One is the sense of urgency to get work on contract. Two is the desire to give a long-term sustained demand signal to industry and commitments around demand to both help us plan, but also to drive down costs that come with change or production gaps if there isn't certainty of demand. The other area is just in the mechanisms for contracting themselves. We're seeing more use of OTAs and other nontraditional contracting mechanisms.

All of these are positive for industry. And I don't see a desire by the department to push industry profitability down. It's quite the contrary, to help reduce costs that benefit both the customer and industry profitability and place incentives on contracts to drive early delivery, which, again, is in everyone's best interest. So I see a real alignment here and an opportunity for us to work with the department to create better economics for industry and the government.

Operator

Our next question comes from Scott Mikus with Melius Research.

Scott Stephen Mikus

Melius Research LLC

Backlogs for you and your peers are already elevated and it seems like a lot of the reconciliation funding from One Big Beautiful Bill is yet to be put on contract. We also could have a \$1.5 trillion defense budget, another supplemental for operation Epic Fury. The demand signals are great, but are we starting to see European customers become wary about ordering equipment from U.S. companies, given that they can't actually be 100% certain when they'll receive the equipment?

Kathy J. Warden

Chair, CEO & President

Scott, there's definitely a desire for European countries to buy U.S. products and we are still seeing robust demand there. There is a sensitivity to buy local if possible if there is a comparable product that can meet the requirements. And there is a sensitivity around time lines for U.S. companies to be able to deliver, particularly given the increased demand from the U.S. and the priorities that we are placing on ensuring that we are delivering on those commitments.

For the Northrop Grumman portfolio, specifically, we have been investing in capacity. I talked about the 20 facilities that we have opened in the last 24 months, the over 2 million square foot of manufacturing space that we've added. This gives us the capacity to do both. We are not finding ourselves needing to trade whether we can meet U.S. commitments or European commitments. We can and are supplying demand for both, and we foresee the ability to continue to do that.

Scott Stephen Mikus

Melius Research LLC

Okay. And then the administration has also talked about trying to increase significantly the number of space-related FMS approvals. Are you starting to see the administration speed up that process? And are you engaged with international customers about building a pipeline of opportunities for your Space Systems segment?

Kathy J. Warden

Chair, CEO & President

We are engaged with international customers related to space capabilities, and we see that pipeline growing. We have seen some contract awards. We, in the quarter, announced a relationship with a Hungarian company and are pursuing work there. So we are starting to see the maturation of that demand signal turning into pipeline and even contract award. I would say that it is the business that has the least international pipeline of our 4 segments, but it's growing, and we expect 5, 10 years from now, international to be a key contributor to our Space business just as it is in our other 3 segments.

Scott Stephen Mikus

Melius Research LLC

Congrats, Todd, on the retirement.

Todd B. Ernst

Vice President, Investor Relations

Thanks, Scott.

Operator

Our next question comes from Scott Deuschle with Deutsche Bank.

Scott Deuschle

Deutsche Bank AG, Research Division

John, is the customer providing any incremental cash advances or working capital support to help offset some of these increased capital investments in the B-21 program?

John Thomas Greene
Corporate VP & CFO

So let me answer the question this way that we're making significant investment to support the program and the customer is making significant investments to support the program. So the cash flow timing related to the program loosely will align with the investment rate, but there's certainly components of it that will not. So that's probably about as much detail as I can get into on the nature of the cash flows related to the program, given the classified nature of the contract and the program itself.

Kathy J. Warden
Chair, CEO & President

And I'll just add that the deal improves the economics for the program for the government and Northrop Grumman. When we look at the return on invested capital over the life of this program, this deal has improved that outlook. And for the government, we are able to produce and deliver capability faster. So in our view and the Air Force's view, this is a win-win, both contributing and both benefiting.

Scott Deuschle
Deutsche Bank AG, Research Division

Okay. And Kathy, for the life of the program, do you see the ROIC now meaningfully above your cost of capital?

Kathy J. Warden
Chair, CEO & President

We do.

Scott Deuschle
Deutsche Bank AG, Research Division

Okay. And then, Kathy, there's been some news reports stating that many F-35 aircraft are delivering without radars. So I was wondering if you could give us an update on that program and how performance has been tracking more recently on your F-35 radar production line?

Kathy J. Warden
Chair, CEO & President

Sure. We're somewhat limited in what we can share with regard to the program, given its classified nature. So I'm more going to refer to some of the comments that the joint program office for the F-35 has made related to where we are. We are building an advanced radar, and we are in the process in coordination with the JPO, taking on concurrent development and production. And this was a known risk when we started down this path to ensure that we could deliver the capability as quickly as possible. The JPO has stated plans to accelerate the production capacity to deliver the radars that meet the requirements, and we are in the process of working with them.

So we are continuing to work to complete the development, which includes testing, then quickly ramp production. And one of the facilities I referenced earlier in the call is being built for the purpose of accelerating the production on this program, in particular. And we've opened that facility. We have the tooling and are working to train the workforce. So we are ready to go as soon as we get through test milestones on the program and are already starting to produce.

Beyond that, the schedule specifically around the program and the modernization plans remain classified. The important takeaway is, we are moving as expeditiously as possible to get this radar delivered because we understand what a game changer it is for the capability.

Operator

Our next question comes from Andre Madrid with BTIG.

Andre Madrid
BTIG, LLC, Research Division

Congrats, Todd. I wanted to ask on -- in the past couple of months, we saw you guys got tapped to support the C2 layer of whatever the Golden Dome initiative ends up looking like. I mean, what additional color can you give there? And how might that eventually materialize in the financials as we progress in the coming quarters and years?

Kathy J. Warden
Chair, CEO & President

We were selected to be part of a broad set of companies that are developing the C2 layer and we're looking forward to contributing to a very aggressive time line for both developing and demonstrating that capability. It is one of General Guetlein's top priorities. And we are optimistic that we bring a lot of legacy experience and knowledge, both in C2 and the understanding of layered defense in the missile defense arena to that team.

Andre Madrid
BTIG, LLC, Research Division

Got it. Got it. Appreciate it. Maybe pivoting to the YFQ-48. I mean a lot of shots on goal there. There's a lot of CCA opportunities, whether it be with the Navy, Air Force, Marine Corps, you name it. I guess just a status check there. Where are we in bidding for those -- where are you in bidding for those opportunities? And I guess, what are your expectations as we move forward?

Kathy J. Warden
Chair, CEO & President

So as you know, we are pursuing a number of opportunities with the Air Force. We were given the YFQ-48 designation so that we can continue to test our offering and that we are progressing toward Increment 2. We have also been awarded for the Marine Corps, our MUX TACAIR offering. And we -- it's been announced as one of the participants in the Navy CCA program. So a broad set of activities underway to take our unmanned experience, the over 500,000 flight hours that we have, the investments that we've made in Talon, both Talon Blue, the aircraft, and Talon IQ, formerly known as Beacon, to test and mature vehicle management systems and autonomy and had some key milestones that we reached on that effort in this quarter that we announced as well and bring all of that expertise forward to all 3 services who are pursuing CCAs and put our best foot forward for offerings in their next competition.

Todd B. Ernst
Vice President, Investor Relations

Josh, we have time for one more question.

Operator

And our last question comes from Matt Akers with BNP.

Matthew Carl Akers
BNP Paribas, Research Division

Congrats, Todd, on the retirement. Kathy, I was wondering if you could touch on the classified restricted portion of your business just because it's a big chunk that's sort of difficult for us to track. And based on what you're seeing, based on the budget request, do you think that grows faster or slower than kind of the other part of your business?

Kathy J. Warden
Chair, CEO & President

We have seen it growing faster than the other part of our business with the strong demand in munitions, missile defense, which are not part of our restricted portfolio. On a go-forward basis, I could envision that the restricted business will grow more in line with the rest of the portfolio. I think the key takeaway is, we see growth in both. And so it's a nice position to be in.

Matthew Carl Akers
BNP Paribas, Research Division

Thanks, I will leave it at one.

Kathy J. Warden
Chair, CEO & President

So I just want to close the call by once again thanking our entire team for their contributions to national security and space exploration. Since the beginning of this year alone, we've boosted North American astronauts back to the proximity of the moon and we have helped our military in several operations in multiple regions across the globe, return home safely after completing their missions. I know our team has been working tirelessly to support these efforts and I'm very proud of them.

I would also like to recognize Todd, as many of you have mentioned, he's completing his final earnings call with us today. It's been my pleasure to work with him over the last 7 years, and we are glad that he chose NG as the place for the capstone for his career as he transitions into what is a well-deserved retirement. So congratulations, Todd.

Thank you all for joining us today. We look forward to continuing to engage with you throughout the quarter. And that concludes our call for today.

Operator

Thank you. Ladies and gentlemen, this concludes today's conference call. Thank you for your participation.

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