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OVERVIEW:

Company Summary

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PRESENTATION

Operator

Good day, ladies and gentlemen. Welcome to Northrop Grumman's Fourth Quarter and Year-end 2023 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 - *Northrop Grumman Corporation - Corporate VP of IR*

Thanks, Josh. Good morning, and welcome to Northrop Grumman's Fourth Quarter 2023 Conference Call. This morning, we'll refer to a presentation that's posted to our IR website. Before we get started, matters discussed on today's call, including guidance and outlooks for 2024 and beyond, reflect the company's judgment based on information available at the time of this call. They constitute forward-looking statements pursuant to safe harbor provisions of federal securities laws.

Forward-looking statements involve risks and uncertainties, including those noted in today's press release and our SEC filings. These risks and uncertainties may cause actual company results to differ materially. Today's call will include non-GAAP financial measures that are reconciled to our GAAP results in our earnings release. And on the call today are Kathy Warden, our Chair, CEO and President; and Dave Keffer, our CFO. At this time, I'd like to turn the call over to Kathy. Kathy?

Kathy J. Warden - *Northrop Grumman Corporation - Chair, CEO & President*

Thanks, Todd. Good morning, everyone, and thank you for joining us. Before discussing our 2023 results, I wanted to take a moment to thank our team for their hard work and dedication to our important mission. Our talented workforce, which is now over 100,000 strong continues to deliver some of the most advanced technologies in the world. These capabilities are used by our customers every day to defend freedom and deter aggression around the globe.

The geopolitical landscape has grown even more complex, driving continued increases in global security spending. Our strategy has positioned us well to compete and win in this growing market, which has translated into accelerating top line growth for Northrop Grumman.

Revenue increased by over 7% in 2023, ending the year more than $1 billion above the midpoint of our original 2023 guidance. In addition, our book-to-bill for the year was 1.14x. That's in line with our exceptional four-year average. As a result of this award strength, we achieved a new record backlog, which now exceeds $84 billion, and that provides a healthy foundation for our continued growth. The underlying performance of our company is strong. We generated free cash flow at the high end of our guidance range, and we comfortably exceeded our sales and EPS guidance range absent the B-21 charge.

While we're disappointed that our assessment of conditions for the low-rate initial production portion of the B-21 program necessitated this charge in the quarter, we are confident in our ability to deliver on the company's forward outlook, which remains unchanged. We're also proud of the performance of the B-21 team which continues to execute an unparalleled aircraft development program.

As we look forward, we will continue to execute our business strategy, which at its core, is based on technology differentiation, a laser focus on performance and value delivery for our customers and shareholders. To support this strategy, we are prioritizing investment in our capacity and capabilities. In 2023, we invested over $2.9 billion in R&D and CapEx, that's 7.5% of sales, to continue driving innovation and capacity to support our customer mission success.

We also delivered over $2.6 billion to shareholders through dividends and share repurchases, representing a return of approximately 125% of our 2023 free cash flow.

So now I'll highlight a few examples of progress we've made across the portfolio that further bolster my confidence in our future. Shortly after the close of the fourth quarter, we announced our GEM 63XL solid rocket booster helped to successfully power ULA's Vulcan launch vehicle on its first mission. Future Vulcan missions will utilize additional GEM 63XLs in support of Amazon Kuiper and other ULA customers providing a significant growth opportunity for our propulsion business. And this is an important milestone because it supports our investment to significantly ramp production capacity of GEM 63s in the coming years.

Global demand for our weapons systems increased in 2023, and we expect this trend to continue. In this market, we're both a supplier and a prime. We're a supplier of propulsion systems, warheads, fuzes and cannons across a highly diversified customer base and a prime contractor for predominantly air-to-ground missiles including AARGM, AARGM-ER and Stand-in Attack Weapon. Weapons systems currently represents approximately 7% of total revenue and based on the demand we're seeing, we expect this business to grow faster than the company average for the foreseeable future, with a significant portion of this expansion coming from international customers.

In our Mission Systems business, demand remains exceptionally strong with a 2023 book-to-bill above 1.2x, the highest of all of our segments. As we've seen in recent years, the restricted portfolio of Mission Systems is a meaningful driver of growth. As our customers pursue solutions that enable them to operate inside the decision loop of potential adversaries who are also advancing their computing capabilities. We are helping our customers stay ahead by developing advanced microelectronics, sensors, processors, and secure communications. Our product lines are enabling faster cycles of modernization, positioning our customers with decision advantage in this rapidly advancing technology environment.

And we continue to make significant progress on the EMD phase of Sentinel, which is the next-generation, land-based leg of the strategic Triad. We are achieving milestones to mature the design and reduce risk, including key test activities such as the successful static fire test of the Sentinel Stage 2 solid rocket motor for the missile earlier this month. Last week, the Air Force submitted to Congress a new set of cost estimates for the program, which triggered a Nunn-McCurdy breach. This in turn, launches a review of the program by the Department of Defense, which we expect to be ongoing for the next several months.

It's important to note that the cost growth is primarily driven by estimates for the command and launch facility build-out, which is part of the military construction and procurement phases of the program. We and our industry team are continuing to perform on the EMD phase in close partnership with the U.S. Air Force. And we'll work with the government to explore opportunities to reduce costs on the program with a focus on the late 2020s and beyond when the program is expected to move into the procurement phase. And in the fourth quarter, the B-21 entered its flight test phase. This is a major milestone for the program and achieving it within the baseline schedule is a credit to the Northrop Grumman team and our close partnership with the U.S. Air Force over the past several years.

Following this milestone, we were awarded the first LRIP lot in the fourth quarter, and production is now underway. Let me take a few moments to provide a little more detail on the B-21 charge, the possibility of which we started talking with you about at this time last year. As you know, like all of industry, we and our suppliers have experienced cost pressure from recent global macroeconomic conditions, which are significantly different from the assumptions the team made when bidding these five production lots in 2015.

During the fourth quarter of 2023, we again reviewed our estimated profitability on the LRIP phase of the program. And we now believe it is probable, each of the first five LRIP lots will be performed at a loss. The charge is largely driven by a change in our assumptions regarding funding to mitigate the impact of macroeconomic disruptions on the LRIP phase of the program and higher projected manufacturing costs that reflect recent supplier negotiations and our experience in completing the first aircraft. The after-tax cash impact related to these updates will be spread over a number of years. Importantly, we have absorbed this effect, and we have not changed our outlook for free cash flow growth over the next several years.

This is a game-changing capability that will be of great value to our nation, and we are focused on executing the program in a way that also delivers value to our shareholders over the coming decades. Turning now to the budget environment. Global national security spending is increasing as the U.S. and allies invest in capabilities to deter and defend against aggression. Demand for our capabilities remains strong, due to our differentiated portfolio and alignment to customer priorities, including the Triad, Space and Weapons.

In the U.S., our franchise programs remain well supported by Congress and the Department of Defense. And this gives us confidence in our outlook even in a constrained U.S. budget environment. We are pleased to have an NDAA in place that provides continued support for defense spending, and we're hopeful that Congress will enact appropriations soon. Our guidance assumes we will not have a shutdown or a full-year CR, and we're encouraged by the progress we've seen so far towards passing appropriations in the March time frame.

Additionally, we are monitoring progress on supplemental funding, and we see opportunities in expanding the industrial base and increasing munitions production in this pending request. Our allies are also increasing their defense spending, and we expect our alignment with their needs for aircraft, weapon systems and mission systems to be an additional source of growth. So as we look to the future, we have the right portfolio and team to deliver on our long-term outlook.

Our organic sales have grown at a greater than 5% annual rate since 2019 and our guidance calls for continued growth of 4% to 5% in 2024. Segment operating margin dollars are expected to grow at roughly the same rate as sales in 2024. And our 2024 EPS guidance range of $24.45 to $24.85 at the midpoint represents roughly 6% growth, excluding the B-21 charge and 11% growth compared to our initial EPS estimates, which we provided in 2023.

In addition, the structural building blocks to expand our margin that we outlined in last year's 2Q earnings call, including dissipating macroeconomic headwinds, implementation of productivity and cost savings initiatives, and future favorable mix shifts remain in place. We are laser-focused on performance and bid discipline to drive margin expansion. And importantly, we continue to expect our free cash flow to grow at a double-digit rate over the coming years.

We are reaffirming our 2024 and 2025 free cash flow outlook and we've also introduced a 2026 outlook of $3.3 billion at the midpoint. With the businesses generating significant cash flow, we have considerable flexibility in deploying capital to generate value for customers and shareholders.

Our top priority remains investing to support our business strategy and we expect to invest over 7% of sales again in 2024 in capital expenditures and R&D.

At the same time, we'll continue to provide strong capital returns to our shareholders. Last month, our Board of Directors increased our share repurchase authorization by an additional $2.5 billion, and we ended the year with a remaining authorization of $3.6 billion. For 2024, we expect to increase our share repurchases to at least $2 billion. This includes a $1 billion ASR that we plan to initiate in the coming days based on the strong liquidity position with which we entered this year. So when we take these factors, sustainable top line growth with expanding margins, and couple those with declining capital intensity and lower projected cash taxes, you get a recipe for robust cash flow growth for years to come.

So now I'll turn it over to Dave to provide you more details on the segment results, 2024 guidance and the forward outlook. Dave?

David F. Keffer - *Northrop Grumman Corporation - Corporate VP & CFO*

Thanks, Kathy, and good morning, everyone. We finished the year with strong momentum, enabling us to reaffirm and build upon our favorable forward outlook. I'll start by elaborating on our 2023 results and then provide additional details on our guidance. On the demand side, we ended 2023 with over $84 billion in backlog, a new record for our company. All four of our segments generated a full-year book-to-bill ratio over 1x sales.

We also continued to deliver strong top line results with Q4 sales of $10.6 billion, up 6% compared to the fourth quarter of 2022. Full year sales were even stronger, up over 7% at $39.3 billion or roughly $300 million higher than our latest guidance. These top line results were enabled not only by the strong demand environment we're seeing among our customers, but also by our ability to ramp on new programs, expand our workforce and convert our backlog into sales.

Moving to segment results. We generated sales growth in each of our businesses in 2023. Aeronautics sales were up 2% for the year, returning to growth earlier than previously expected. AS growth was driven by higher volume on restricted programs that more than offset declines on mature production programs. DS posted sales growth of 5%, led by higher volume in the weapons and missile defense portfolio. Mission Systems sales were also up 5%, driven by higher restricted sales on advanced microelectronics programs and higher volume on Marine Systems programs. And our Space business posted another quarter of double-digit top line growth, with sales up approximately 14% for the year. Nearly 40% of the growth came from Sentinel and NGI with the rest coming from our broad Space portfolio.

As Kathy described, our segment margins included a charge for the B-21 program. The charge was primarily driven by the confluence of lower assumptions around macroeconomic disruption funding and higher production cost projections. While the full pretax charge had the effect of lowering our segment margins, only $143 million has been recorded as an EAC adjustment, including a $43 million reduction to Q4 sales. The remaining was booked as a contingent liability because the majority of the lots have yet to be awarded.

The charge also led to an $82 million benefit in corporate unallocated expense stemming from a reduction in deferred state taxes. Continuing with our results, Slide 5 shows the comparison of our 2023 earnings per share to the guidance we provided in October. Diluted EPS includes a $2.08 unfavorable mark-to-market adjustment from our pension plans and a $7.68 per share impact from the B-21 charge. Absent these items, we would have exceeded the high end of our prior EPS guidance range by over $0.40.

Our 2023 mark-to-market adjusted EPS also included significantly less pension income compared to 2022. In total, net pension costs generated a $4.07 per share headwind in 2023.

Next, I'll take a few moments to discuss our cash flows. As is our historical pattern, we had an outstanding quarter of cash performance in Q4, generating $1.6 billion in free cash flow. For the full year, our operating cash flow was $3.9 billion, and our free cash flow was $2.1 billion. This result was near the high end of our guidance range and represented free cash flow growth of 30% compared to 2022. Turning to pension results, we generated strong asset returns of roughly 11% in 2023, ahead of our long-term assumptions. The FAS discount rate declined by roughly 40 basis points to 5.15%.

Netted together, along with updated Census data, this generated a mark-to-market pension expense of $422 million in our GAAP results. Slide 7 in our earnings deck summarizes our pension estimates for the next three years. We continue to expect CAS recoveries to increase from current levels, providing a benefit to our cash flows, but slightly less than prior projections and we expect a higher level of nonoperating FAS pension income in the coming years driven by our strong asset returns in 2023.

In total, our funded status remains superb at nearly 100%. And we continue to project minimal cash pension contributions over the next several years. Turning to 2024, slide 9 in our earnings deck includes our segment level guidance. Building off the strong top line results in Q4, we now expect Aeronautics sales in the low $11 billions, driven by growth on B-21 and on other programs such as F-35 and E-2D. This is higher than our prior sales estimates for AS, which reflected a flat 2023 and modest growth in 2024.

Higher B-21 sales also result in a slightly lower margin rate expectation for AS which we now project in the mid-9%, netting out to a similar volume of margin dollars compared to prior estimates. DS sales are expected to be roughly $6 billion, up low single digits from 2023. As we mentioned on the Q3 call, DS has really turned the corner on growth through strong demand for weapons and missile defense capabilities. We are optimistic in our ability to convert these opportunities into sustained growth in this business over time, which we expect to be partially offset by modest declines in the sustainment and training portions of the business.

Margins are projected to remain strong at DS in the low 12% range. Mission Systems sales are expected in the low to mid-$11 billion range for another year of mid-single-digit growth with margins of roughly 15%. And at Space, after expanding sales at a greater than 17% CAGR since 2019, growth is expected to moderate in 2024 with higher segment margins. Space sales are now expected in the mid to high $14 billion range with margins of approximately 9%. The mid-single-digit growth rate in Space reflects declines in a restricted program due to shifts in government priority, which are more than offset by growth in other parts of the Space portfolio.

Having built a tremendous backlog in recent years, Space now has an opportunity to deliver strong ROI through more measured growth along with margin expansion and cash generation. At the company level, our guidance reflects growth in sales and segment margin between 4% and 5%, absent the B-21 charge, consistent with the outlook we provided on our October call, even after delivering top line upside in Q4. We expect another solid year of bookings with a book-to-bill around 1x. And similar to our cadence over the last few years, we expect sales to ramp throughout the year with first quarter sales a little less than 24% of our full-year estimate.

We plan to be in the market soon for new debt issuance to take advantage of the favorable rate environment. The proceeds from the debt issuance will also be used in part to support refinancings of $1.5 billion of notes that are coming due in January of 2025 as well as for general corporate purposes and share repurchases, including the $1 billion ASR we intend to initiate in the coming days. We've reflected this debt issuance in our interest expense guidance, and we'd also expect interest income to contribute to the EPS line as it did in 2023.

We project an effective tax rate of approximately 17% in 2024, consistent with the range we've experienced over the last few years, excluding the mark-to-market adjustment and other unique items. We're coming closer to conclusions on a number of open audit and appeals processes with the IRS, which could have positive or negative effects on book and cash taxes as they're resolved over the next couple of years, and our forward guidance does not include any such adjustments. Similarly, we have not factored any potential changes to R&D tax legislation into our outlook. And as a reminder, our interpretation of current tax law results in a projected five-year impact from R&D amortization of approximately $2 billion.

We will continue to track these matters carefully and provide updates as they progress. In total, we expect our 2024 earnings per share to be between $24.45 and $24.85 with approximately 148.5 million weighted shares outstanding.

Moving to cash, we expect 2024 free cash flow between $2.25 billion and $2.65 billion, consistent with our prior outlook. And as we've said before, capital expenditures are expected to remain elevated in 2024 before moderating in 2025 and beyond. Slide 11 in our earnings deck provides an update to our long-term free cash flow outlook to include 2026. We continue to expect our free cash flow to grow at a double-digit rate for several more years with additional growth in the second half of the decade.

This expansion will be driven by sustained growth in our business, generating strong operating margin volume and converting those profits into cash. Meanwhile, lower cash taxes, higher CAS recoveries and lower levels of capital spending in the coming years provide additional structural levers to expand our cash flows at a rapid rate. Importantly, these ranges also include the latest estimated cash impacts associated with the B-21 charge. We expect roughly 60% of the charge to affect cash flows through 2026 with the remainder in the following years.

Longer term, we are confident we'll be able to continue to absorb the cash headwinds from B-21 while delivering excellent free cash flows in 2027 and beyond.

In closing, I want to thank the entire Northrop Grumman team for their contributions to another great year. The strength of our portfolio and visibility of franchise programs provides us the opportunity to deliver and deploy robust cash flows as we execute on our strategy. And with that, let's open up the call to Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Kristine Liwag with Morgan Stanley.

Kristine Liwag - *Morgan Stanley, Research Division - Executive Director, Head of Aerospace & Defense Equity Research and Equity Analyst*

Kathy, on the B-21, you've been very clear about the pressures on this program. Ultimately, how much relief did the customer extend to you to offset macro pressures on the LRIP portion. And is there still a possibility of future relief?

Kathy J. Warden - *Northrop Grumman Corporation - Chair, CEO & President*

So Kristine, we've been working with the customer. And as we noted, those conversations continue. And last year, in 2023, we and the Air Force disclosed that about $60 million of $1.5 billion that Congress appropriated for inflation was allocated to the advanced procurement for Lot 1 on this program. But we have yet to work through what that relief may be in future lots. We have, of course, as we said, updated our assumptions and through conversation and the tight budget environment, we've actually lowered those expectations for inflation relief. And so at this point, our focus is on executing this program and finding opportunities in the performance on the program while we continue to work with the government to see if there is any inflation relief opportunity.

Operator

Our next question comes from Richard Safran with Seaport Global, you may proceed.

Richard Tobie Safran - *Seaport Research Partners - Research Analyst*

So I know you're going to get a lot of questions on the B-21, but I thought I'd ask you about -- just to expand on your opening remarks about Sentinel. I thought you might talk a bit more about the actions you're taking to get the program back on track. How are you seeing risk on the program right now? And I guess, importantly, what you think the government's level of support for the program is given all the headlines and what we've been seeing?

Kathy J. Warden - *Northrop Grumman Corporation - Chair, CEO & President*

Yes. Thanks, Rich. So as the land-based leg of the nuclear triad, Sentinel is a top priority for the Department of Defense. The requirement for the program has been validated numerous times by multiple administrations, and we expect that to be the outcome of this latest review.

As the Air Force has reported, the Nunn-McCurdy Cost Breach on the program is largely due to cost growth in the military construction and procurement segments of the program, and we and the industry team are currently executing on the cost plus EMD phase of the program. That's important because our design work in this phase is helping the Air Force to better estimate the costs of those later phases and due to a number of factors of learning their cost estimates for these later phases have increased, and that's what's driving the Nunn-McCurdy Breach as the Air Force has said, growth on the EMD would not have triggered the breach.

I'll also note that their update captures the inflation since 2020, the last time they did a cost estimate. And we all know that there's been significantly higher inflation than what was assumed at that time. So some of that is what you're also seeing reflected in these latest cost estimates. I mean with that said, though, you asked about our performance on the program, and I'm really pleased to report on the progress that our team has made over the last three years while we've been executing on the EMD phase. We've onboarded thousands of engineers. We've matured the system design. We've produced and tested critical hardware in the missile system, as I've outlined earlier on the call.

We've also engaged in risk reduction, which is helping to inform the Air Force launch facility modernization and we've done all this while also doing detailed planning for the future phase of the program. I, myself, have visited the missile fields, actually I was at one last Friday, which is part of why I've got this cold I brought back. And I met with the airmen, who have committed themselves to this important mission. So we're all in. We know how important this is, our team is partnering closely with the Air Force, and we're going to help them to deliver this essential capability for our nation.

Operator

Our next question comes from Ron Epstein with Bank of America.

Ronald Jay Epstein - *BofA Securities, Research Division - MD in Equity Research & Industry Analyst*

So maybe just jumping back to B-21. Charges like this on programs have a tendency to accumulate over time. They don't tend to go the other way. How should we think about it as we go forward? I mean, this is what for the first five LRIPs, how many LRIPs could there be? And how do we think about the bounds on this? And then maybe one last thing. Is the program NPV positive and if it is, when does it actually become NPV positive, cash flow positive, so on and so forth. If you could just peel back the onion on the program.

David F. Keffer - *Northrop Grumman Corporation - Corporate VP & CFO*

Sure. I can go ahead and get started with that. And see if we can address a number of questions you raised. First of all, in terms of the future, we'll continue to update our projections every quarter as we do with all of our large programs. But it's important to note, we have a lot more information today than we did at this time last year, having completed the production in the ground test phase of the first aircraft.

We also have the majority of the suppliers now under contract with the remaining in advanced stages of negotiations. We have our latest estimates for productivity and reasonable learning curves that we believe are appropriate based on our historical experience. Of course, we now have one lot under contract, and we'll finalize quantities of the next four lots over time as well. And the economy and inflationary factors have stabilized a bit over the past year, and we'll continue to track those, of course, over time as well. But perhaps most importantly, we're still performing well on this program, which is continuing to provide a critical capability for our customers.

In terms of the long-term NPV, we think that the most important thing is that our customers will get great value from the aircraft. We'll deliver them over time, and that should, over time, also lead to value for the company and our shareholders.

Operator

Our next question comes from Douglas Harned with Bernstein.

Douglas Stuart Harned - *Sanford C. Bernstein & Co., LLC., Research Division - SVP and Senior Analyst*

I wanted to go back to the Sentinel program. And when -- what you've described is that I think is that EMD is going well. But when you look at where this is headed and what came out with the Air Force commentary on the Nunn-McCurdy Breach. A couple of things that I wanted to understand better. They're talking about potentially a two-year delay in IOC, they're also -- also you talked about it a little bit, but to understand how much of this breach is due to potential changes in requirements and things that are, in a sense, under your purview versus those that may be under others, including the government customer?

Kathy J. Warden - *Northrop Grumman Corporation - Chair, CEO & President*

Yes. So as you note, there is a delay to IOC, the reason though for the Nunn-McCurdy Breach is the cost growth. So oftentimes scheduled delays add costs to the program, that is not the primary contributor. It is, as you noted, design decisions, particularly related to the command and launch requirements that the Air Force has and that affects the deployment in the launch facilities in each of the missile silos. And so that is what we are working to inform the Air Force decision process on alternatives and ways to reduce those costs and procurement and yet those are Air Force cost estimates, and they include a significant amount of scope that is outside of the industry team's execution. But nonetheless, we will help to inform those discussions if they're ongoing during this review process.

Douglas Stuart Harned - *Sanford C. Bernstein & Co., LLC., Research Division - SVP and Senior Analyst*

And does the delay in the timing, does this have much effect right now on your outlook for the overall profitability of the program.

Kathy J. Warden - *Northrop Grumman Corporation - Chair, CEO & President*

It does not, Doug, our near-term assumptions on both the ramp of the program relative to sales as well as the profitability on the program are not materially impacted.

Operator

Our next question comes from Sheila Kahyaoglu with Jefferies.

Sheila Karin Kahyaoglu - *Jefferies LLC, Research Division - Equity Analyst*

Kathy or Dave, maybe if you could just talk about the free cash flow guidance that you're sticking with the 15% CAGR. Just the drivers in terms of top line, working capital, Section 174, and the impact of B-21. Dave, I think you said 60% of that or $600 million is through '26. Is that right? And do we think about Sentinel as a positive cash contributor?

David F. Keffer - *Northrop Grumman Corporation - Corporate VP & CFO*

Sure. Thanks for the question, Sheila. I'm happy to dig into that. The strength of the free cash flow outlook we really think of as one of the highlights of our report today. And so happy to dig into that in more detail. And I think you heard correctly that 60% of the charge is associated with the period through 2026 from a cash flow perspective. I think importantly, the strength of the broad base of other programs across the business is serving to offset those pressures. And that's what we're seeing in our ability to maintain and build confidence in our multiyear outlook, including adding a strong 2026 year to that outlook that continues the double-digit growth trajectory that we expect for the next several years.

We had a great finish to 2023 for free cash flow, really strong working capital performance, and that is enabling us to build confidence in our ability to continue to perform at similar levels going forward. As a company, we've put a lot of focus on working capital efficiency, on capital efficiency, on driving cash returns on recent investments and that is clearly showing up in the results and the performance of all of our sectors. We're proud of their performance on cash in Q4 and in the outlooks for '24 and beyond. And the net effect of all of these factors is that unchanged free cash flow outlook for '24 and '25, along with a strong '26.

I'd highlight in terms of what drives that going forward? What's the underlying force as you point out. Certainly, the operations of the business growth in the top line is, first and foremost, with an opportunity for growth at the margin rate line as well that leads to really strong margin dollar volume, which will convert into cash through the strong working capital performance that we expect to continue which is essentially a stable assumption in our outlook. We're not looking for significant additional efficiencies given just how strong we were at the end of 2023.

And then as we noted earlier, there are other structural factors that should help as well with CAS pension reimbursement growing slightly over the next few years and cash taxes projected to decline over that same period. So essentially, all of those factors will lead to strong -- strong free cash flow growth outlook for the next several years and beyond.

Operator

Our next question comes from Seth Seifman with JPMorgan.

Seth Michael Seifman - *JPMorgan Chase & Co, Research Division - Senior Equity Research Analyst*

I guess a two-part question about B-21. First was the $143 million EAC in the quarter, is that the extent of the entire anticipated loss on Lot 1 and I guess, how do we think about the progression of losses on the various lots? And then second, the fact that this charge includes lots that will be in budgets in 2026 and 2027 and not come under contract for a while and not be worked on for a while. I guess how would you assess the opportunity to maybe ultimately do a little bit better than anticipated here?

David F. Keffer - *Northrop Grumman Corporation - Corporate VP & CFO*

Sure. I can start on that, Seth. I think you've read properly into the $143 million EAC adjustment with Lot 1 having been awarded and the others not yet awarded, that one does take the form of an EAC adjustment. So that $143 million is the Lot 1 amount we are currently projecting. And the future progression while we can't get into much detail because that would involve lot sizes and quantities and other classified details. Clearly, the implication is that there's modest growth from Lot 1 to future lots on average.

Over time, I think you're thinking of this the right way that our current projections would indicate an average of a couple hundred million dollars a year of after-tax impact on our -- on the cash line from B-21, and that's, as I referred to a few minutes ago, the headwind we've been able to mitigate through strength in the rest of the business. In terms of your point about opportunity to outperform that over the long term. Clearly, it is a core focus of our team to continue to drive efficiencies in the learning curves, successful outcomes of our negotiations with suppliers. We continue to engage and partner with our customer to understand macroeconomic impacts on the program and address opportunities for funding of relief, as Kathy mentioned earlier.

And so we'll continue to address all of those opportunities. This is something we'll update you and the rest of the Street on over time.

Operator

Our next question comes from Cai von Rumohr with TD Cowen.

Cai von Rumohr - *TD Cowen, Research Division - MD & Senior Research Analyst*

So anyway, so you had the loss on the B-21 kind of it didn't look like a loss couple of quarters ago. You've had your second loss on HALO. This is clearly proving to be an environment where on fixed price contracts, there is more risk. Have you changed your strategy regarding how you bid and specifically with reference to Tranche 2 of the tracking satellites because you were on Tranche 1 and you were not on Tranche 2. So have you changed your strategy in terms of how you're bidding? And are there any contracts that you bid before changing your strategy that would still have risk that we're not aware of today?

Kathy J. Warden - *Northrop Grumman Corporation - Chair, CEO & President*

Very insightful question as always, Cai. So when you look back to 2015, when we bid B-21, we certainly have changed our view on bidding of contracts where we did not have a mature design at the point of bid and yet we committed to fixed price options into the future. And we have, to my knowledge, not done that again. And we have passed on some high-profile programs as a result of the risk balance that the customer put forward in the RFP not meeting our standards.

We have programs like HALO, which we have certainly learned some additional lessons and are applying those as we move forward. And you note on some very recent bids, we have taken a different approach in looking at firm fixed price, where we've either declined a bit if the customer chose to go fixed price or we've offered a price in the case of SDA Tranche 2 that we thought was fair and reasonable and the customer decided not to further negotiate with us. These are things that are going to happen and we're going to remain disciplined. We have plenty of opportunity in this company to grow. We have a strong pipeline of opportunities we're pursuing. And a strong pipeline of opportunities that we believe have the right risk/reward balance with industry.

Operator

Our next question comes from Gavin Parsons with UBS.

Gavin Eric Parsons - *UBS Investment Bank, Research Division - Analyst*

Maybe just following on Ron's question. Does the B-21 charge contemplate current conditions as they are? Does it have some consideration for future uncertainty in macro or supply chain?

Kathy J. Warden - *Northrop Grumman Corporation - Chair, CEO & President*

With all of our EACs, B-21 included, we do our best based on what we know today to project conditions out into the future. Now with that said, that's difficult to do the longer term that period of performance is. So in this case, we're looking out over greater than five years. So as we get into those out years, that's a bit more speculative, but we do incorporate our expectations for changes in everything from material, labor pricing to productivity and learning.

Gavin Eric Parsons - *UBS Investment Bank, Research Division - Analyst*

Okay. Understood. And Dave, you mentioned the IRS appeal process. Any way to put a range around the possible cash impact on that?

David F. Keffer - *Northrop Grumman Corporation - Corporate VP & CFO*

No, I'd refer you to our tax disclosures for more than enough detail on all of those fronts. It's tough to put a range around those things. We're looking forward to getting through those processes, as you know, from those disclosures, we have a lot of open years that have yet to be resolved and looking forward to working with the IRS to come to reasonable resolutions there, and we'll update you on any book or tax differences from current reserves as we get there.

Operator

Our next question comes from Scott Deuschle with Deutsche Bank.

Scott Deuschle - *Deutsche Bank AG, Research Division - Research Analyst*

Dave, can you give us a sense for the proportion of supplier costs across the five LRIP lots that have now been fixed versus what's still open to negotiation?

David F. Keffer - *Northrop Grumman Corporation - Corporate VP & CFO*

Sure. As we noted a few moments ago, we're now at a majority of the supplier costs that have been fully negotiated across the LRIP phase. And we're in various stages of negotiation with suppliers for the remainder. So that's one area where we have learned more and progressed in our process compared to where we were a year ago or even a quarter ago.

Scott Deuschle - *Deutsche Bank AG, Research Division - Research Analyst*

Okay. Great. And then just as a follow-up, where does the commercial inventory come from in the Space business? And is that EBIT headwind mostly gone now? Or is there any more of that left to come in '24?

David F. Keffer - *Northrop Grumman Corporation - Corporate VP & CFO*

Sure. Thanks for the question. We had offsetting effects in 2024, in 2023, rather, including Q4 in the commercial elements of the Space business. As you know, those are much smaller than and kind of tangential to the core national security Space business that we have. In the case of those commercial inventory write-downs, those were related to newer investments in product lines to address burgeoning market opportunity in both the government and commercial elements of the Space market. We did see some modest write-downs in various quarters in '23 associated with those. Those are the types of things you occasionally go through as you make such new investments.

So again, not core to the current or future growth story of the Space business.

Operator

Our next question comes from Ken Herbert with RBC Capital Markets.

Kenneth George Herbert - *RBC Capital Markets, Research Division - Analyst*

Maybe, Kathy, at a high level, I wanted to follow up on your comments earlier regarding sort of the key margin drivers you outlined last year. Specifically more on the cost and productivity efforts and maybe on the mix side, are you seeing incrementally more opportunity now as we think about '24? And how should we think about sort of the absolute opportunity on those now into this year versus perhaps how much more of a benefit we see in '25 and beyond.

Kathy J. Warden - *Northrop Grumman Corporation - Chair, CEO & President*

Thanks, Ken. We laid out three drivers, the first of which being stabilization in macroeconomics, and we are certainly seeing that in '24, which is why we see our margin rates this year in line with last with some opportunity for improvement as we go throughout the year. We layer on top of that cost and productivity actions that we are taking in the company, and that will provide some tailwinds in '24 growing tailwinds into '25. And the mix shift really is a bit of a longer-term proposition for us. We've talked about that being a shift from cost type to fixed price, where we expect 2023 was really our high watermark for cost type, but a very gradual shift in that mix to fixed price with more of it coming in the latter half of this decade.

And then international mix is the other where we don't expect significant international growth in 2024, but we do expect that to step up based on our pipeline and particularly the strong weapons demand outside the U.S. in 2025. That gives you a sense of what will be a tailwind to margin rate and when.

Operator

Our next question comes from Myles Walton with Wolfe Research.

Myles Alexander Walton - *Wolfe Research, LLC - MD & Senior Analyst*

I was wondering, Dave, or Kathy, you previously talked about a $4 billion free cash flow target in 2028, effectively doubling what you've done in '23. I just want to make sure that's still on the table, despite the charge absorption in that period of time? And then maybe, Kathy, on the margin expansion specific to Aerospace, is that still a 10% margin business? Or do we have to glide slope down a little bit further into '25, '26.

David F. Keffer - *Northrop Grumman Corporation - Corporate VP & CFO*

Thanks for the questions, Myles. Let me kick off with the 2028 free cash flow number. I appreciate the question on that because I think that too is core to the outlook going forward. Yes, we are reaffirming that $4 billion target for 2028, essentially doubling the level that we were projecting at the midpoint of our 2023 guidance, which was $2 billion. Of course, we exceeded that by $100 million in our final result for 2023. The drivers of that growth are much of what we've talked about already. Certainly, growth in the top line. As Kathy just noted, some of the drivers of margin rate expansion opportunity which leads to margin dollars having an opportunity to exceed the growth rate of our top line through 2028.

And importantly, CapEx will moderate during that same period. So we've noted that '23 and '24 of these peak years of capital intensity that continues to be our outlook with declines in '25 and beyond. And then pension and tax will serve as tailwinds during that same period. So that leads you to the $4 billion number. And I think if you look at the '24 and '25 numbers we've reiterated for our free cash outlook today and add in that '26 range, you'll get to that same glide slope that would push you upward toward the $4 billion number by 2028. So those are the building blocks and the way we plan to get there.

Kathy J. Warden - *Northrop Grumman Corporation - Chair, CEO & President*

And Myles, on AS margins, what we're seeing, as Dave noted earlier is that with the B-21 growth being a bit stronger than we had anticipated, AS is stepping up on top line. It is putting some pressure on margin rate, but margin dollars are exactly where we had anticipated they would be coming into 2024, and our guide therefore, remained consistent for AS on a dollar basis, even though we now are looking at more of a mid-9s rate projection.

As you go out over time, it's less dependent on what happens with absorbing that lower rate on B-21 and more what happens in terms of other new programs coming into the AS portfolio and the rate at which we will book those programs. So we'll provide you more insight into that over the coming year as we look towards 2025 and beyond.

Operator

Our next question comes from Robert Spingarn with Melius Research.

Robert Michael Spingarn - *Melius Research LLC - MD*

Kathy, a few minutes ago, you alluded to international and I wanted to bring up IBCS because it's had some strong demand signals from international customers and thought maybe you could dig into that program a little bit, give us a sense of how large it is in revenue or how -- in '23 or '24? And how big it might be, let's say, five years from now?

Kathy J. Warden - *Northrop Grumman Corporation - Chair, CEO & President*

It certainly is an area of strength in our portfolio. We've seen strong performance by the team on the U.S. Army program and also as we are deploying in Poland, and we see follow-on opportunities in Poland as a result. We've also, as I've spoken about throughout the course of 2023, added a number of additional countries who have expressed interest in the program to the pipeline, and that's what would drive the growth that we anticipate in the 2025 time frame.

As you noted, I mentioned international demand. Part of that is weapons, part of that is the IBCS portfolio. And then, of course, we have some aircraft and Mission Systems strength in the pipeline for international in 2025 as well. The program itself is growing at a fairly rapid rate, but off of a relatively small base, it's about $400 million of annual sales. And so we expect that to grow, of course, but not a major contributor, at the enterprise line for growth.

Operator

Our next question comes from George Shapiro with Shapiro Research.

George D. Shapiro - *Shapiro Research - CEO and Managing Partner*

Kathy, I wanted to ask on the charge for the B-21, what caused it to be bigger than the 0 to $1.2 billion range that you've kind of been reiterating since last year? And then just specifically, maybe the margin that you had said would be around 10% is now maybe 9.5%. I know you alluded to a few minutes ago, the B-21 was growing faster. But it's got to grow a lot faster to drop the margin by 50 basis points. So I was just wondering if you could explore that a little bit more.

Kathy J. Warden - *Northrop Grumman Corporation - Chair, CEO & President*

Let me start with the first part of your question and Dave will cover the second. As we noted, we identified this risk last year, and we, throughout the year, revisited it on a quarterly basis. There were two primary changes in the fourth quarter that both led us to deem it a probable loss as well as impacted the value of that loss.

First, we significantly reduced our projections for funding related to macroeconomic impacts, as we've talked about a couple of times already. Although we continue to partner with the government to address these impacts. We believe it's prudent in light of the current budget status to reduce those assumptions. And so we did that.

The second is we've experienced growth in our cost projection, both in the internal production costs as we've continued to build aircraft as Dave talked about through our negotiations with suppliers. We have learned and built that learning into the forward-looking estimates that we now have in the EAC, so those were the factors. As we've talked about, we did a very detailed look at this EAC in the fourth quarter and had matured and had actual data to reflect on that we did not have at an earlier point.

David F. Keffer - *Northrop Grumman Corporation - Corporate VP & CFO*

Let me follow up on the second part of your question because I do think it's an important nuance. The AS business was operating in the mid-10 billions in scale over the past year, it exceeded our original expectations in sales in 2023 and now is projected to exceed them even more significantly compared to where they were a year ago in 2024. We were talking about a flat '23 and very modest growth in '24 based off of that mid-10s level. And now we're all the way up into the low 11s. And so that low 11s at a mid-9% margin rate is the same as the mid to high 10s at a slightly higher margin rate.

We're really focused on driving the dollar volume of operating margin in our Aeronautics business and across our business, it's that return on invested capital, the growth in margin dollars and in free cash flow that results from it, that is really our core focus.

Todd B. Ernst - *Northrop Grumman Corporation - Corporate VP of IR*

Josh, we have time for one more question.

Operator

Our final question comes from Jason Gursky with Citi.

Jason Michael Gursky - *Citigroup Inc., Research Division - MD & Lead Analyst*

Dave, just a clarification question for you to start. You mentioned in your prepared remarks that there were some shifting priorities from the government in the Space business that was leading to a deceleration in growth. I was wondering if you could provide a little bit more color on what those shifting priorities might be? And then Kathy, I just wanted to provide you maybe a bit of an open-ended question to kind of wrap all this together here. Just broadly talk about all the risks and opportunities that you see in front of you on the execution side of things.

You've obviously got record backlog here and we know about the B-21 risk. But I'm wondering if you could just maybe highlight and wrap this all together, do we have a balanced risk and opportunities portfolio here, we a little bit more overweight risk than we are opportunity? And maybe just kind of dive into a little bit of the details of what you're seeing and maybe what you're all doing to address those issues.

David F. Keffer - *Northrop Grumman Corporation - Corporate VP & CFO*

Sure. Great questions, Jason. Let me go ahead and start with your original question on the National Security Space portfolio. As we mentioned, our guidance captures growth and declines in various programs across all of our portfolios, very much including Space. In the case of Space, as we've noted, there are some shifts in budget priorities. A lot of our customers are having to address budget prioritization, particularly as it relates to 2025 and beyond.

With that said, in this particular case, given that it's in the restricted domain, there's not much more we can say about the mission or the program or anything like that. What's important there is that our Space sector, and therefore, company guidance accounts for our latest understanding of all the programs in that portfolio and the likely paths forward for them. And I think when you look at the Space guidance, you see a lot of value creation as they continue to grow the top line. And in this case, now grow margin rates alongside that with lower capital intensity starting in '25, in particular, you see a lot of improvement in returns on invested capital in the Space business, given how much growth they've built in their foundation over the last few years. Kathy?

Kathy J. Warden - *Northrop Grumman Corporation - Chair, CEO & President*

And Jason, I really appreciate the question. I wish I had another hour to discuss it with you, but being respectful of everybody's time, let me just simply say that I see our portfolio and the set of opportunities and risks we have as balanced and consistent with what I have seen in recent years since I stepped into this role. We have a team who has stepped up and provided top line growth, which I believe is industry leading at about 5% on a compound annual basis through each of the last four years. We're projecting that again this year. We see the opportunity space is rich, both domestically and internationally. And to the risks that we have in executing this portfolio, while the pandemic certainly made that more challenging for the last couple of years. We're turning the corner.

Our overall program performance has not been stronger since I've been at the company, and that's 15 years and going. So I really feel good about how this team is positioned. We now have fully disclosed and taken into the P&L, the B-21 risk, which we've been talking about and feel confident that we can now go execute this program. And I am proud of what the team collectively has accomplished across 2023 and look forward to the outlook we have in place for 2024.

So with that, I just want to again thank my colleagues at Northrop Grumman for their dedication, both to our country and our company. I also want to thank you for joining us today, and we look forward to speaking with you on our next earnings call in April. So Josh, that concludes the call. Thank you.

Operator

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