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OVERVIEW:

Company Summary

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to Northrop Grumman's First Quarter 2024 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, and good morning, everyone, and welcome to Northrop Grumman's First Quarter 2024 Conference Call. We'll refer to a presentation that is posted on our IR website this morning. Before we start, matters discussed on today's call, including guidance and outlooks for 2024 and beyond, reflect the company's judgment based on information available at the time of this call. They constitute forward-looking statements pursuant to safe harbor provisions of federal securities laws.

Forward-looking statements involve risks and uncertainties, including those noted in today's press release and our SEC filings. These risks and uncertainties may cause actual company results to differ materially. Today's call will include non-GAAP financial measures that are reconciled to our GAAP results in our earnings release. And 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*

Thank you, Todd. Good morning, everyone. It's so good to have you joining us today. So earlier this morning, we released our first quarter results. And as you can see, we are off to a strong start to the year with broad-based growth across our portfolio. The team's relentless execution of our strategy, which includes technology leadership aligned to our customers' priorities and a laser focus on performance has positioned us for continued success. Growing global demand for our capabilities led to an exceptional 9% year-over-year increase in Q1 sales, driven by growth in all four of our sectors.

The productivity and cost efficiency measures we've been implementing are gaining traction, and our program performance in the quarter was strong, resulting in segment operating margin dollars increasing by 10%. Operating profit expansion, along with the lower share count helped to drive 15% EPS growth. Overall, our first quarter performance was in line with or better than our expectations, and we are reaffirming our 2024 company level guidance. Global demand for our products continues to be robust, fueled by rising defense budgets and our market position. We're pleased that an agreement was reached on the U.S. fiscal year 2024 defense budget, which includes support for our key programs and represents a 6% growth in investment accounts over 2023.

In March, the Administration released the 2025 Defense budget and Future Years Defense Program or FYDP. And these also were consistent with our expectations. We continue to see robust support for our program portfolio in areas that include nuclear modernization, microelectronics, advanced weapons, and space. Together, the appropriations and FYDP give us confidence in our longer-term outlook even if we experience a somewhat slower top line growth environment for the U.S. Defense budget in the short term.

As we look beyond the domestic market, we continue to see numerous new international opportunities as well. These span a wide range of capabilities across our portfolio, and they provide an additional avenue for sustainable and profitable growth. In the first quarter, Poland signed a letter of acceptance with the U.S. government for an additional implementation of our IBCS product line, known as NAREW. This represents the short-range air and missile defense portion of Poland's missile defense architecture, and it will augment the medium-range portion, which is currently being deployed. In addition to Poland, we see an IBCS pipeline now of approximately $10 billion from numerous countries who are considering this joint battle management system.

Another important suite of international opportunities for Northrop Grumman is sensor modernization of fourth-generation aircraft. This includes our IVEWS electronic warfare offering, which leverages the U.S. program of record. IVEWS has been down selected by two international partners, and we are in discussions with seven other countries. Overall, IVEWS has the potential to be a new multibillion-dollar product line for us. We're also well positioned to address emerging international opportunities for autonomous systems.

The first of four Triton aircraft is expected to be delivered to Australia later this year. In addition, NATO is actively looking to expand its maritime surveillance capabilities, enabling a higher degree of interoperability amongst allied nations. We believe our Triton program is well suited to meet these requirements, providing an opportunity for up to five aircraft. And we see additional Triton opportunities emerging elsewhere in Europe.

There also continues to be an uptrend in U.S. and allied partner demand for missile products and ammunition. This includes several significant ammunition opportunities for allies that in aggregate have the potential to support further growth in our Defense Systems portfolio at solid margins. And this week, the U.S. Congress passed supplemental funding bill, which includes munitions procurement and missile product capacity expansion.

As we shared in our prior calls, to meet growing demand across our weapon systems business, we have been investing in our largest solid rocket motor production facility over the past five years, and we have now tripled our production capacity for tactical SRMs.

Technology leadership is an important part of our business strategy. And we've been investing to maintain our lead in microelectronics for defense applications. To further this objective, we recently established the Northrop Grumman Microelectronics Center, which brings together our microelectronics capability from across the company into one organization. It will be led by our Mission Systems business, where over 80% of their revenue is enabled by our innovation and investments in microelectronics.

Today, our U.S. microelectronics facilities produce over one million microchips a year with tailored design, fabrication and advanced packaging needed to support the most advanced defense systems and sensors. We also work with leading-edge technology developers in the commercial space, like NVIDIA to incorporate their technology into our national security solutions. In addition to advancement in capability, we are expanding our capacity in this important technology area.

In the quarter, we held a groundbreaking ceremony for our new advanced electronics facility in Waynesboro, Virginia. With this $200 million investment, we are increasing our ability to manufacture and test advanced electronics and mission solutions. As I mentioned earlier, we are laser-focused on performance and driving cost efficiencies in our business. This includes deploying systems and tools that help enable increased productivity across our business.

In the first quarter, we completed the implementation of a significant financial ERP upgrade, which consolidated multiple versions of our prior system, and it will significantly improve the efficiency of our operations. This new system provides a foundation that supports many of the other digital transformation initiatives. And it plays an integral role in our longer-term margin expansion strategy. The upgrade, as you would understand, was a massive undertaking that was achieved with minimal disruption to our business. It's really a credit to the entire team who worked tirelessly to achieve this outcome.

We also continue to proactively address our overhead costs and indirect rates to drive affordability for our customers. We saw benefits of this in the first quarter, particularly in production programs at both AS and DS. Efficiency in both direct and indirect cost management continues to be a priority across the company.

Program execution is another area of particular emphasis in 2024. In our Space sector, after rapid growth over the last several years, we are keenly focused on delivering key capabilities for our customers, executing our extensive backlog and generating strong returns in the process. This includes the progress we're making on the Sentinel program. We're continuing to execute the EMD phase of the program, and we've made solid progress on design and development activities for the facilities and support equipment as well as the missile itself.

The Nunn-McCurdy review is continuing, and we are providing support to the Department of Defense in that process as well. It's a complex undertaking to modernize the U.S. strategic deterrent, which requires delivering the most advanced capabilities in the world to form the basis of that deterrent. We're honored to be part of this vital mission, so we're partnering with our customers in bringing the focus, resources and talent needed to deliver on those commitments.

Finally, I'd like to provide an update on our capital deployment strategy. First and foremost, we are investing in capabilities that meet our customers' needs to address rapidly evolving threats. This year, we continue to expect that we'll invest roughly $1.8 billion in capital expenditures bringing our total investment to nearly $8 billion since the beginning of 2020. These investments have contributed to our strong growth performance and outlook. At the same time, we are efficiently returning capital to shareholders, including nearly $1.5 billion in the first quarter.

So in summary, with a broad portfolio of well-supported programs, continued new domestic and international opportunities, a relentless focus on performance and a capital deployment strategy designed to create value for customers and shareholders alike, Northrop Grumman is well positioned for the future.

So with that, I'd like to hand the call over to Dave, and he's going to cover some of the details of our financial performance and outlook before we take your questions. Dave?

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

Thanks, and good morning, everyone. As Kathy highlighted, we're off to a strong start to the year. Sales, operating income and EPS all increased meaningfully from the first quarter of 2023 as we execute on our backlog and drive efficiencies in our business.

Starting with our top line results on Slide four in our earnings deck. First quarter sales increased 9% to $10.1 billion. We were pleased to deliver higher Q1 sales at all four of our segments. These results were ahead of our initial projections for the first quarter, due in part to the timing of material volume on certain programs. With that in mind, we expect a more gradual ramp in our quarterly sales profile than in the past few years. I'll address the factors contributing to this as I walk through updates to our segment guidance.

As AS sales were particularly strong, up 18%, driven by higher volume on the B-21 program as well as on mature production programs like F-35. Defense Systems sales increased 3%, primarily due to growth on multiple programs in our weapons business, and as expected, were partially offset by lower volume on an international training program.

Mission Systems sales grew by 4%, led by rapid growth on advanced microelectronics programs in our restricted portfolio, partially offset by lower volume on SABR. And sales at Space increased by 9% with broad-based growth throughout the portfolio, including on the SDA transport layer programs as they continue to ramp.

Turning to the bottom line, we remain laser-focused on performance. In Q1, we generated segment operating income of $1.1 billion, a year-over-year increase of 10%. Margin rate was also solid at 10.9%. As we've outlined on previous earnings calls, we expect to increase our margin rate over time as mix shifts favorably, macro conditions improve, and productivity measures continue to bear fruit. Aeronautics operating income increased 25% for an operating margin rate of 10%. Efficient indirect rate performance, driven by productivity initiatives and careful cost management helped to generate a healthy volume of favorable net EAC adjustments. These adjustments were recognized across the AS portfolio but primarily benefited mature production programs.

On B-21, there were no significant changes to our EACs, and we continue to make good progress in the test phase of the EMD program and on the build of the LRIP production units in flow. We have finalized negotiations with additional suppliers on the LRIP phase of the program and are in the late stages of negotiations with the remaining.

Defense Systems operating income grew 11%. They also benefited from favorable mix and indirect rate performance, driving their OM rate to 12.5%. At Mission Systems, segment operating income increased 5% and margin rate increased 20 basis points to 14.2%. MS's OM rate benefited from favorable mix on higher-margin advanced microelectronics programs, partially offset by lower net favorable EAC adjustments. We see opportunities to further improve performance at MS, driven by operational efficiencies and investments we've made in our factories. Lastly, Space operating income increased 6% and its margin rate was a solid 9.1%.

Moving to earnings per share on Slide six. Diluted EPS were $6.32 in Q1, an increase of 15% from the prior year. The increase was driven by our strong growth and segment performance, as well as from higher net pension income and a lower share count.

Turning to cash flow, we're pleased with our cash performance, particularly in light of our ERP conversion that went live in the first quarter. This was a significant undertaking that will help to drive additional efficiencies in our business over time.

Q1 free cash flow was an outflow of approximately $1 billion, and we expect a strong quarter of cash generation in Q2. This profile is consistent with our seasonal pattern of generating the majority of our free cash flow in the second half of the year.

Moving to guidance, we are reaffirming our 2024 company level guidance and have a few updates at the segment level. We continue to project a book-to-bill ratio close to 1x for the year. Note, we expect a higher ratio at AS, DS and MS and a lower ratio at Space, given all the backlog growth that has generated in recent years and flattening U.S. Space budgets. At the company level, we expect our second quarter sales and segment margin volume to be roughly in line with the strong Q1 results with modest expansion in the second half. We expect the quarterly profile to vary at the segment level, so I'll take a moment to provide some additional color.

First, DS and MS sales and margin dollars are expected to ramp throughout the year, generally consistent with prior year patterns. Restricted programs in MS continue to expand, and the DS weapons business has significant demand that Kathy described, which should lead to further second half growth.

Our margin rate guidance was adjusted slightly higher at DS and slightly lower at MS, reflecting our Q1 performance and latest expectations for the remainder of the year. At Aeronautics, we are increasing our sales guidance to the mid-$11 billion to reflect our strong Q1 results and our latest projections for B-21 sales timing. But the quarterly sales profile is projected to be different this year than it was in 2023. The timing of materials volume, primarily on F-35 and B-21, drove additional Q1 sales, so we'd expect a flatter profile through the remaining quarters. As our full year guidance indicates, AS margin rates are expected to be lower in subsequent quarters based on business mix and the strength of Q1 EAC adjustments. For the full year, we continue to expect margins in the mid-9% range.

And at Space, we're lowering our sales guidance to the low to mid $14 billion, which roughly reflects 3% annual growth. Sales volume is now expected to trend lower over the remaining quarters of 2024, reflecting the NGI decision and the contract termination in restricted Space that we noted last quarter. This is expected to be partially offset by continued growth in Sentinel and the SDA portfolio. Below the segment line, we are reaffirming our company-level guidance reflecting the strength of our broad portfolio. We continue to expect corporate unallocated costs to be weighted toward the second half of the year, consistent with prior years.

Interest expense will also be higher in future quarters due to the additional debt issuance in Q1, and we continue to project an effective tax rate around 17%. As we've noted before, we're monitoring any changes in tax legislation and any updates in our tax appeals processes, that by their nature, are not factored into our guidance.

And as a reminder, we completed a $2.5 billion debt offering at attractive rates shortly after the filing of our 10-K. The proceeds will be used in part to retire $1.5 billion of notes that are maturing in January 2025, as well as for general corporate purposes, including share repurchases. We initiated a $1 billion accelerated share repurchase in Q1, which is now nearly complete. In total, including our open market purchases, our Q1 repurchases were $1.2 billion. For the full year, we have increased our expectations for share repurchases to greater than $2 billion.

We also remain committed to providing a strong and growing dividend. Our capital deployment plans are enabled by our ability to generate strong and predictable cash flows in our diverse and durable portfolio. We continue to project industry-leading investments in our business to support our customers while returning excess cash to shareholders. We're confident that this business strategy will create value for all our stakeholders.

In summary, we're off to a great start to the year, and we remain upbeat about our long-term outlook.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

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

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

Kathy, if you could speak to just maybe a little more detail in that $95 billion supplemental, what potentially is in there for Northrop given everything you guys have been doing in those related businesses?

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

Yes. Well, as I noted, we are pleased that the supplemental did pass this week. And as we are looking through it, there are a number of areas that align to our program portfolio. Some where we are prime in weapons programs, others where we are a supplier of solid rocket motors. And then there is a line for additional capacity expansion. I talked about the capacity expansion that we have done for solid rocket motors in our largest production facility that over the last several years has enabled us to triple capacity, there is additional funding that would take that capacity even higher and reflects what's needed to support those programs that are funded in the supplemental.

So, we are bullish on the opportunity to fulfill that demand through both the investments we've made and the additional capacity that we can lay in over these coming months and years.

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

And maybe just a quick follow-on, if I may. With the push out of F/A-XX, I mean how does that have -- like what strategic impact does that have on the Aeronautics business?

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

There are a number of opportunities in Aeronautics that we are pursuing, that being one of them. It doesn't really have an impact on our near-term outlook for that business. As we shared today, we're raising the sales guidance for that business this year, and that's really on the strength of the current portfolio and the growth that we continue to see there, but we will continue to pursue additive opportunities, the Navy program being one of them.

Operator

Our next question comes from Doug Harned with Bernstein.

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

You talked a little bit about outlook for book-to-bill this year and backlog was down in each segment in Q1. I understand some of the Space issues. But on AS, DS and MS, if you're looking at a book-to-bill of above 1 for the year, can you talk about where that's likely to come from? What will drive those business units since the backlog was down in Q1?

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

Yes. Doug, as we've talked about before, awards can be very lumpy, and so we tend to look at our book-to-bill over a longer stretch of time. And our last two years have been well over 1, so we expected this first quarter to be lighter and we had signaled that. As we look at the full year, we still believe that we'll be near 1. And it's largely going to be driven by our shorter-cycle businesses, so think Mission Systems and Defense Systems and Space will clearly be the lowest as we digest the NGI loss and, of course, the cancellation that we had in the first quarter. But I'll remind you, our Space business has nearly doubled over the last four years, and the book-to-bill there has been incredibly strong. So they're still carrying a large backlog of business that supports the growth rates that we're projecting for them.

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

Well, and then just on Space, you mentioned the importance of Sentinel and you've talked over the last quarter about some of the Nunn-McCurdy breach and those issues. But when you look at the Air Force moving the IOC schedule back by two years, how does that affect your growth path on Sentinel?

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

We had talked about Sentinel growth coming, flattening out for a few years, and then returning to growth as we moved into the production phase later in the decade. That still holds true. That timing has, of course, moved as the program schedule is moving, but the profile still is quite similar to what we have been discussing. And it was so far out in the future, it really wasn't in any of the projections that we had in '24 or even '25. It was well beyond that. Still a healthy ramp is expected for that program, and we are laser-focused on delivering and meeting the schedule commitments that we are working towards with the Air Force.

Operator

Our next 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*

The Air Force lowered its near-term requested funding levels for B-21 in the fiscal year '25 budget proposal. And they talked about lower negotiated prices on low-rate production. How does this change, alter the economics of the program and risks of incremental charges?

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

It doesn't change the economics of the program. What happened is the budget was set based on the independent cost estimates. And as we move towards the contract phase where LRIP was exercised the first option, the government is now reconciling to our contract value. There was no change in price, schedule, quantities. It's just a reflection of them moving off an independent cost estimate and moving to our contract value, which, of course, was lower than their independent cost estimates.

Operator

Our next question comes from Sheila Kahyaoglu with Jefferies.

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

Kathy, I wanted to ask about DS. Maybe can you talk about the puts and takes there just given supply chain as well as services and incremental opportunities such as IBCS and Missile Systems. How do you think about the trajectory just given some of the positive movements we've seen in missiles, and missile defense and obviously, supplementals and the driver of potential margin improvement there?

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

Yes. So our Defense Systems portfolio has been undergoing a transformation over the past several years. As you know, we divested the services business, and we still have a sustainment and modernization business. That business has been flattish. And this year, we talked about a headwind in that business to growth associated with an international training program. You see that weighing a bit on first quarter growth in DS being 3%. Over time, we expect that growth rate to reflect the other two portions of the business more and more as that mix shifts toward weapons and our battle management portfolio. That's where IBCS sits.

I spoke on today's call about some of those opportunities, both domestically and internationally in the weapons and the IBCS portfolios. And so we expect those to contribute to growth, and they are also higher margin than our sustainment business. So as that mix shifts, so will margins improve.

Operator

Our next question comes from Seth Seifman with JPMorgan.

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

Kathy, I wanted to ask on autonomous aircraft and the CCA program, we saw last night the news about Anduril selection along with General Atomics. And I was wondering if you can -- with that news, maybe update us on Northrop's strategy to capture new work in the autonomous space.

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

Yes. So we're obviously disappointed to learn that we weren't selected on this phase of the CCA program. The U.S. Air Force has described this acquisition strategy as a continuous competition and they're already outlining future phases. So we'll see what that presents in terms of future entry point. We also see the other services in the U.S., and I talked about international partners as well, continuing to look to add to their autonomous vehicle fleet. And so we are pursuing those opportunities.

We haven't learned anything at this point that fundamentally changes our strategy in autonomy, but we'll monitor how the CCA program progresses and will incorporate any learnings that we have into those future opportunities. And for us, you didn't ask, but this phase of the program was relatively small. We didn't have it assumed in our plan. So there's no impact to the guidance that we shared this morning for the AS sector.

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

Okay. Okay. Great. And then maybe a follow-up on it. When you think about where you want to be focused in autonomy. I guess the legacy of the company is more on the exquisite side, and there will probably be some demand for that, but also demand for quantity and -- which requires affordability. Do you plan to pursue opportunities in both of those submarkets or really focus more on that kind of legacy exquisite piece of the market?

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

We are obviously working toward affordability in our product line, so we do not want to be viewed as only offering exquisite and expensive technology. So we've been working to drive down the cost of our offerings, and I think we had quite a compelling offering on CCA and can compete in that marketplace. We are really positioned to provide the best solutions that our customer needs against a high-end threat, however. We are not looking to compete in a more commoditized part of the market that's very low cost and not survivable systems. That's just not our business model, and we know that. So we'll remain disciplined in where we invest in the pieces of the market that we pursue, but we think that what we provide is still highly relevant.

Operator

Our next question comes from David Strauss with Barclays.

David Egon Strauss - *Barclays Bank PLC, Research Division - Research Analyst*

Kathy, I wanted to ask about MS margins. A couple of years ago, we were running in the 15 level, they stepped down a little bit last year. You took down a margin guide there. Can you just kind of talk about what's driving the lower margins? Is it just solely mix that's driving the lower margin in MS?

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

It's a bit of mix as we've been talking about. They have a higher cost plus mix now than they have historically, and we expect that to shift over time, but they are still at a high watermark. And there also is a productivity element to the story. We've talked about supply chain disruption as we have ramped, and we are also increasing the scale of that business. You see a mid-single-digit level growth in Mission Systems. But with price coming down on microelectronics, it's actually a much higher volume ramp than is reflected in the total sales growth of the business.

So, as we have climbed that ramp, productivity has taken a bit of a dip. But as we said, we're focused on getting back to our prior performance levels at now this higher volume level, and we see that as something this team is very capable of doing. And that's why you see a margin profile that always is start a little slower and ramp through the year for MS, but you'll see it again reflected this year based on those productivity improvements that we expect to achieve throughout the year.

David Egon Strauss - *Barclays Bank PLC, Research Division - Research Analyst*

Okay. Got it. And then similar question over on the Space side. So you took down the top line there, I assume that was partially NGI. The slower growth, should we see that potentially reflect itself in a little bit better margin profile? I know you kept the margin guidance unchanged at [9%] (added by company after the call), but I guess the NGI loss and just a little bit slower growth, could that actually help the -- help enhance the margin side of things.

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

Yes. As we look at the slower growth, it is largely development programs that are dilutive to the, both Space margin rate and the company margin rate. So as -- that part of the business is no longer as significant. You will see that be both margin and cash tailwinds because there was also CapEx investments planned that we will not extend in those programs now either.

Operator

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

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

Good performance, Kathy. So following up on Dave's focus on Space, I think I've got two questions. First, the restricted program that was canceled, is there any chance that we heard a rumor it might have been related to a supplier issue? Is there any chance that, that function or that program might reappear again in the future?

And secondly, the SDA business, you basically decided not to bid one contract. Is that as a group, are those profitable contracts? Because every time I look, there's another new small supplier coming in and they're all fixed price contracts.

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

So let me start with your first question on the restricted program. There's very little I can say, given the nature of that program, except to say that the Air Force canceled that program largely due to budgetary concerns and prioritization, but the requirement likely does still exist. And so we will see how that plays out over time. I also -- as we look at the broader Space portfolio, will answer your SDA question more generally. We see a whole variety of opportunities that we can pursue, so we're simply selective on which ones we're best positioned to win, where we think that we can price competitively.

And with SDA, we've been quite successful and those programs are profitable. But that's because we're remaining disciplined in choosing where we can best compete and win with a reasonable fee and the probability of success.

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

But you did no-bid that one program. As we move forward, is the pricing here getting a little bit more competitive as more people join the party?

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

The way I think about bid strategies is if there is an area where you have a differentiated value, then you are going to be able to price accordingly. If you don't, you won't. And so we don't bid when we don't feel like we have a differentiated value that's going to be successful with the price we need to bid to both win and execute. It's really a decision we make on every capture. It's fundamental to the way we both commit and execute as well as deliver the returns that we expect. So no change there and no difference in Space than it is in other parts of our portfolio.

Operator

Our next question comes from Robert Stallard with Vertical Research.

Robert Alan Stallard - *Vertical Research Partners, LLC - Partner*

Kathy, I just wanted to follow up on your comments at the start of the call where you talked about the FY '25 request and DoD spending leveling off. I was wondering who you think could be the bill payers in that budget scenario or whether there's any vulnerability in the Northrop Grumman portfolio?

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

We looked at the FY '25 President's Budget as very much in line with our expectations. So no surprises and no concerns about our portfolio. Obviously, we talked about two things where budget was a factor. in MDA choosing to down select early on NGI was largely due to budgetary constraints. And then, of course, the restricted Space program that we mentioned, but those we have now digested and, of course, reflected not only in our outlook, but my comments about the FY '25 budget.

So nothing else that we see in there that is concerning. And as I noted, '24 ended up being a strong year for the investment accounts with 6% growth over '23. And we also have the supplemental on top of that. So it's early in looking at '25 and where the budget environment will actually end up in the U.S. But I also just keep pointing back to international demand, that's the strongest that I've seen in a long time. And so we look at global demand, not just the U.S. marketplace.

Robert Alan Stallard - *Vertical Research Partners, LLC - Partner*

Which is -- I've got a quick follow-on on that actually because you did mention exports as well. And I was wondering if you could give us an update on what sort of scale as a percentage of revenues, exports are at the moment and what that could grow to in the future.

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

They're about 14% right now. And while we don't see that moving significantly in the near term because those opportunities I noted in the pipeline do take a while to prosecute and turn into sales. We do expect that, that will be a faster segment of growth than our domestic business over these next several years, just the richness of the pipeline.

Operator

Our next question comes from Pete Skibitski with Alembic Global.

Peter John Skibitski - *Alembic Global Advisors - Senior Analyst*

Kathy, can you talk about Northrop's role in the shipbuilding supply chain, which I guess is the Marine unit in MS. Just because the Navy has talked about some of the supply chain challenges in shipbuilding. Maybe you could just kind of assuage any concerns maybe in terms of how that unit is performing and the growth outlook there? And just kind of how you guys are managing that unit to just so we have a good feel that smoke doesn't turn into fire kind of scenarios?

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

Absolutely. It's a critically important part of our portfolio. We're very focused on delivering for our customers in that portfolio. And there have been challenges that we own. We've been working on a development program for nearly 10 years. It's going to deliver an amazing step function improvement in propulsion for the Columbia class submarines. And we are near delivering the first pair of turbine generators. And that's what the Secretary of the Navy was referring to in his testimony on the Hill.

We are working to address supply chain challenges, as you have heard across the entire shipbuilding enterprise, our experience is very consistent with that. These programs are long cycle. And so we only go through these development efforts once over a multi-decade period and there's learning that happens. But in this case, I think we are largely through that learning and on a path for delivery, and we're optimistic of the future ahead in being able to deliver this capability.

From a financial perspective that you asked about, this is relatively small, so not something that you should think of as having a material financial impact, but that doesn't mean we don't take it very seriously.

Operator

Our next question comes from Scott Deuschle with Deutsche Bank.

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

Dave, just to clarify, what's the message on Space growth beyond this year? Does it reaccelerate off this 4% or so this year?

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

Yes, I appreciate the question. As you know, we'll provide more specific guidance for all of our businesses and at the enterprise level later this year and provide some indications on the October call as is our traditional approach. I think the broader themes that we've talked about in Space today are important. We've touched on the restricted program cancellation, and the NGI down select news. But broadly speaking, the doubling of that business's backlog over the last five years, the 17% CAGR in sales over that business in the last four years, both position us really well for continued success in that business.

And there is margin rate and margin dollar expansion opportunity on top of that. So we'll provide more specifics as we go about the combination of headwinds from the items we mentioned and tailwinds from the continued growth on other programs. So more specific later in the year, but we continue to be confident in the long-term outlook of the Space business.

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

Okay. Great. And then, Kathy, you flagged opportunities for increased demand for ammunition from U.S. allies, so I was wondering if you could talk a bit more about maybe the specific ammunition products that allies are looking to purchase from Northrop? And in which regions you're seeing that demand percolate? So I understand that there's at least one specific European supplier of ammunition that generates something like 25% operating margins off that revenue. So just curious to understand what that opportunity could mean for Northrop.

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

Yes, of course. So as we look at our weapons portfolio today, it's about 6% to 7% of revenue. It's growing double digit, and we expect that to continue. A good part of that growth will be supported both by the supplemental that I spoke about in my opening comments in response to Ron's question, but also the European demand has strengthened. So we have a number of opportunities, countries across Europe looking to do the exact same thing the U.S. is doing in replenishing stockpiles for munitions.

And those are basic and nonstandard ammo contracts that we have. Our business grew nicely last year. We expect that to continue this year. And we also have programs like AARGM, where there's international demand, that's a longer-term proposition as we look to provide those products to our European allies, particularly as they field the F-35. So a wide ranging set from ammunition all the way up to tactical missiles. And then, of course, our solid rocket motor facility expansion supports many of our peer programs like GMLRS, PAC-3, looking to be a second source to support SM-6, all of those opportunities are in the mix for us.

Operator

Our next question comes from Myles Walton with Wolfe Research.

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

Kathy, you provided a ton of international color both in your opening remarks and also a follow-up to Rob's question. But when I look at the sales disclosures, it's been pretty locked in at $5 billion for five years of absolute dollar revenue. So is there a color you can give us on the backlog that shows that this international opportunity is at least working its way into backlog, if not sales in the coming year?

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

Yes. So in terms of backlog, what you would look to see as we signed the IBCS deals that I mentioned with additional countries, as we sign the contracts for Triton that I highlighted in the call today, the IVEWS that are in the early stages, the two countries progressing toward awards. These are all awards that would be in new franchises that we have not had in the past. While we continue to see just the standard growth in areas like

F-35 international and the Triton portfolio with the Australian buys that are already underway or our E-2D franchise with France and Japan. So those are still in the backlog and then you'd add to that, the opportunities that I highlighted this morning that are new franchises for us.

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

Okay. So the percent of the backlog that's international has been expanding though, I think, is what you're saying?

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

It has, although really what we see now is a whole set of opportunities for product lines that were not in our backlog over the last five years, so that's the difference. Our portfolio has largely been high-end capabilities that aren't exportable. And as you look at how the portfolio has evolved over time, these new franchises that I spoke about today, or franchises like Triton now getting permissibility for exports to more countries, is really opening up a whole new set of opportunities for our company.

Operator

Our next question comes from Gavin Parsons with UBS.

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

Kathy, you mentioned you've finalized negotiations with additional suppliers on the B-21. Were those all in line with your expectations? Can you share what percentage of suppliers are now locked in? And then when you expect that to be fully finalized?

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

So they were largely in line with our expectations, which is reflected in the fact that we had no EAC change in the quarter. We are far along in negotiations with all of our suppliers, and we expect to be closing on those shortly that we're making sure that we have the best deal possible and that we work those negotiations diligently. So I've not set a time barrier to the team, more so an outcome set of objectives for them, and they're doing quite well against those expectations. And our suppliers are obviously key to us. We want to make sure that they are able to support the investment in this program that's necessary. And so, we're taking their interest in line as well.

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

Okay. Great. That's helpful. And then, Dave, maybe just on Aeronautics margin, I think you mentioned the strength in 1Q will be a little lighter through the rest of the year. But was 1Q as expected? Was that in guide? Or did you perform better than you thought you would in the first quarter?

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

The first quarter was particularly strong. As we mentioned, we had anticipated an opportunity for productivity gains and indirect rate-driven enhancements to the margin as well this year that was baked into our guidance. And the timing was such that a lot of that came in, in the first quarter, which is why we've noted that we expect the margin rate to be slightly lower in subsequent quarters than it was right out of the gate set at 10%. And so while there's no single onetime item in the first quarter, it was a particularly strong start and a great way to kick off the year for AS.

Operator

Our next question comes from Matt Akers with Wells Fargo.

Matthew Carl Akers - *Wells Fargo Securities, LLC, Research Division - Senior Equity Analyst*

I wanted to ask on Sentinel, you mentioned you're supporting the Nunn-McCurdy review. Just curious what you think the outcomes of that could be? And if there's any risk to that program or do you think that's not the case just given sort of how critical it is.

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

Well, there has been strong bipartisan support for the program. We expect that will continue. It, of course, is the nation's policy as reviewed in the nuclear posture review to have three legs of strategic deterrence. So we do expect that the program will be recertified, but the government needs to take the process seriously. It's a good process. And they're working through the phases of that recertification now. And as I said, we're providing support to them and stay committed and very focused on delivering the program in the meantime, not getting distracted by the activity associated with the Nunn-McCurdy but supporting it fully.

Matthew Carl Akers - *Wells Fargo Securities, LLC, Research Division - Senior Equity Analyst*

Yes. Got it. And I guess one for Dave. Just thoughts on where EACs at the company level kind of go from here, you're still running quite a bit below where you were a couple of years ago, it sounds like AS had some good EACs, but just thoughts on the progress from here.

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

Sure. I agree with your characterization that there was good progress in the first quarter. And you'll see that further detailed in our 10-Q disclosures as well. We had been running substantially above the levels of 2022 and 2023 in prior years before the macroeconomic disruptions. And so over time, we anticipate that we will normalize to levels more like our history and we saw progress towards that in the first quarter, as you mentioned, particularly in AS.

But really across the business, you're seeing the results of our heavy focus on program performance and cost efficiency. It's one of the three drivers that we anticipate for margin expansion, along with business mix enhancement, and the gradual decline of macroeconomic pressures. And so across those three dimensions, we see an opportunity to continue to see margins normalize over the next several years, and Q1 was a good example of what you can anticipate there.

Operator

Our next question comes from Jason Gursky with Citi.

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

Kathy, I was wondering if I could ask you to dive a little deep on the Space business in two areas, maybe starting with sensors and payloads. And talk a little bit about the pipeline of business opportunity that you have there, where you're seeing the most interest kind of -- like type of sensor, letter optical communications, SAR, RF, that kind of thing. Just talk a little bit about the general kind of ecosystem and what's going on in the sensors and payload business that you've got there and what you're kind of excited about today?

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

So we are seeing interest in modernizing really the entire architecture in Space. And I've been talking about this for a while, so whether it's intelligence surveillance reconnaissance, communications, missile warning and tracking, the entire Space architecture is being upgraded, both in terms of advancing the capability of those sensors and payloads but also the coverage with the broadening of the Space architecture. And so we're involved selectively in all of those areas. As you know, we play a key role in ISR communications, and varying forms of both missile tracking and missile warning.

So really, we feel we have a very broad portfolio that stretches across those areas, we don't focus in on one over the other, and we see them all equally attractive. And really, in many ways, that modernization is well underway and is what has contributed to the strong growth of our backlog in Space over the last few years.

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

Okay. And maybe a similar kind of discussion on the ground systems side of things and whether that's all the sensor payloads that we're launching up into Space are driving the ground system business, just kind of what the competitive environment looks like for you there?

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

Yes. They are, and we do participate in the ground segment. I'd say our strength is more in the sensors and payloads, but we look at a full integrated solution and often are asked by the government to support them on the ground systems development that go with the satellites that we're fielding. And so we see that as a marketplace where we absolutely can compete. We just choose to be a bit more selective there. Again, back to where we're more differentiated.

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

Josh, have time for one more question.

Operator

And our last question comes from Peter Arment with Baird.

Peter J. Arment - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Nice results. Kathy, can you maybe just talk a little bit about what you expect on your CapEx kind of profile. When we think about last year, you had a big step up and things are staying elevated here, but you also have just tremendous demand signals, both domestically and internationally. Just how you're thinking about how CapEx should trend? Have you made enough of the investment? It sounds like you have on the solid rocket side and microelectronics, but just thinking about more broadly?

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

Yes. Some part of why we highlighted today some of those investments that we're making that will support growth over the long term is to reflect the statements that we've made that we do see this year being the peak 4% of revenue CapEx expenditures and then starting to see those come down gradually more towards a normalized level in our company, still see those as a robust growth environment. And so there will be investments that we're making. We're committed to do that. But we do not see the same demand for those investments over the next several years that we've seen over the last several.

Good well, thank you all for joining us on the call today. We -- as you see, we're off to a strong start to the year, and we will carry that momentum into the following quarters as our team focuses relentlessly on delivering that technology advantage for our customers and value to our shareholders. So thanks again for joining us. I look forward to speaking with you on our next call in July.

Operator

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