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Presentation

Operator

Good day, and thank you, ladies and gentlemen, and welcome to Northrop Grumman's Second Quarter 2026 Conference Call. Today's call is being recorded. My name is Josh, and I will be your operator today. [Operator Instructions] I would now like to turn the call over to your host, Mr. Adam Barr, Head of Investor Relations. Mr. Barr, please proceed.

Adam Barr
Director of Investor Relations

Good morning, and welcome to Northrop Grumman's Second Quarter 2026 Conference Call. Before we begin, please note that matters discussed on today's call, including guidance and outlooks for 2026 and beyond, reflect the company's judgment based on information available at the time of this call. They constitute forward-looking statements under the 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, which may cause actual company results to differ materially.

Today's call will also include non-GAAP financial measures, which are reconciled to our GAAP results in the earnings release. Additionally, we refer to a presentation that has been posted to our Investor Relations website. Joining us on the call today are Kathy Warden, our Chair, CEO and President; and John Greene, our CFO. With that, I'll now turn the call over to Kathy.

Kathy J. Warden
Chair, CEO & President

Thanks, Adam. Good morning, everyone, and thank you for joining us on our second quarter 2026 earnings call. As we celebrate America's 250th birthday, we are reminded of the importance of our work in support of preserving freedom and protecting our way of life. It was a moment of pride for our Northrop Grumman team when the B-2 flew over our nation's capital on July 4, a symbol of American strength and ingenuity.

It was also a powerful reminder that many of our technologies have transformed the aerospace and defense industry from the world's fastest microchip and the James Webb Space Telescope, to our signature flying wing technology that epitomizes the B-2 and B-21 stealth bombers. Today, we operate with a sense of urgency to get these technologies into the hands of our customers, with the quality they depend on and the speed to meet today's dynamic threat environment.

Our Northrop Grumman team is embracing the call to action from our nation's leadership. We are partnering with our customers to more rapidly develop and deliver the next generation of capabilities, while scaling and investing in advanced factories to increase production rates and volumes. We are fully aligned with the U.S. government priorities and see significant opportunity and increased demand for our portfolio.

There is bipartisan support for defense investment to maintain our nation's competitive edge. Congress is making progress on fiscal year 2027 authorization and appropriations. The House and Senate Armed Services Committees and the House Appropriations Committee each supported $1.1 trillion in the base budget for the Department of War (sic) [Department of Defense], an increase of nearly 10% from the fiscal year 2026. Additionally, the administration recently submitted a supplemental request for $67 billion for the Department of War to fund recent operational costs, replenishment of weapons, and enhancements to military readiness.

Congress is considering the supplemental and the administration's $350 billion reconciliation package, which is intended to expand and modernize the nation's military capabilities by investing in priority programs and the U.S. defense industrial base. While Congress and the administration are still working through the legislative process, Northrop Grumman's core programs remain well supported in the base budget request, which provides us continued confidence in our growth outlook.

Around the world, there are unprecedented levels of defense investment, as allies accelerate their modernization efforts. Increased global defense spending represents a powerful commitment to our collective security and a recognition of the global threat landscape. At the NATO Summit a few weeks ago, our allies pledged $50 billion in additional investments, including a commitment for Northrop Grumman's Triton autonomous aircraft.

In the Middle East, modern missile defense systems remain an essential priority for ensuring national security. Momentum continues to build in numerous countries to acquire our IBCS system, which is proven and operational today. This includes Kuwait, who in May received authorization from the State Department for 6 IBCS systems. And in Australia, we were selected to establish an in-country solid rocket motor manufacturing facility. These announcements from the second quarter underscore the breadth of international demand for our production-ready systems.

As highlighted in this morning's second quarter release, Northrop Grumman's financial performance reflects continued strong results. We delivered $20 billion in net awards in the quarter, driving a book-to-bill ratio of 1.84x. Backlog continues to grow, including a new record high of $105 billion. And we expect continued strong bookings for the remainder of the year as well as increased momentum in government outlays. These dynamics strengthen our confidence and outlook for accelerating sales growth in the second half of the year. Sales increased by 5%, supported by growth in all 4 of our segments, and operating performance has been solid throughout the business.

We did have lower operating margin rates in DS and Space this quarter due to 2 programs with negative EAC adjustments. At Space, we progressed on the root-cause investigation on the GEM 63XL program, and we are implementing corrective actions to address the anomaly we experienced on a launch in the first quarter. These include a component redesign, which has now been proven in a successful static fire test. We expect to begin delivering the re-designed motors by the end of the year. This additional work and the needed material are reflected in our updated EAC position.

At DS, we continue to invest in our strategy to design and produce tactical missiles. We are executing this strategy through investments in 2 related programs, Stand-in Attack Weapon, or SiAW, for the U.S. Air Force, and AARGM-Extended Range for the Navy. In the quarter, we recognized higher projected costs to complete qualification testing on SiAW. Despite the negative performance reflected on GEM 63XL and SiAW in the quarter, we are confident in our team's ability to complete qualification and successfully deliver these products.

They each provide necessary capability for our customers and represent billions of dollars of potential sales at accretive margins over the next decade. Based on our strong Q2 results and accelerating momentum, we are increasing our financial guidance for 2026. Robust bookings are continuing, and we now expect a full year book-to-bill ratio of at least 1.25x. Sales are now projected at $44 billion at the midpoint, which is over 5% organic growth. We are maintaining our expectations for segment margin performance, and we raised EPS estimates by $1.20.

Our rapidly expanding backlog provides a strong foundation for growth this year and beyond. I highlighted new international opportunities a few minutes ago, which support our multi-year goal to double annual international sales to $10 billion by 2031. Now, I'd like to spend a few minutes outlining developments from this quarter, which further bolster our U.S. growth outlook.

We continue to make progress on the Sentinel program in partnership with the Air Force. This led to further definitization and authorization for us to execute additional elements of the program plan, resulting in a $7.6 billion increase in program backlog. During the second quarter, we achieved contract incentives, which improved overall profitability and delivered program milestones as scheduled. Let me share a few important examples of this progress.

We completed an acoustic test of the Sentinel missile, which validated the system can withstand the intense conditions of a silo launch. Another crucial step towards achieving first flight of the integrated missile, which is expected in 2027. The solid rocket motors for the first 5 flight tests are already in production. And last week, we broke ground on yet another advanced facility at our campus in Utah, adding to the existing 1.1 million square feet of existing space, which was purpose-built for Sentinel. This new facility will support the production phase, which starts later this decade.

We are seeing first-hand the Department of War embrace the use of multi-year agreements to achieve some of its top priorities, particularly on tactical missile programs. When you couple our proven performance as a supplier of solid rocket motors with the additional production capacity we've already brought online, we're positioned to be a qualified rocket motor provider on new programs. Last month, we completed qualification activities to become a supplier on PAC-3, and we reached a $2 billion framework agreement with the Department of War and Lockheed Martin.

We expect the PAC-3 SRM production award later this year. In total, we have 10 multi-year agreements for missile acceleration in work across the portfolio with up to $10 billion of sales opportunity over the next 7 years. These agreements provide a clear demand signal to industry and Northrop Grumman while delivering a greater value and efficiency for our customers.

Another area of increasing budget priority is national security space. Modern warfare is driving demand in this market, with every service now depending on space-based capabilities, leading to historic increases to the U.S. Space budget. Today, our national security space backlog stands at over $16 billion, with programs like GPI, GWS and restricted efforts. For the full year, our national security space business is projected to grow high single digits and generate over $7 billion in sales, accounting for more than 15% of company revenues, driven by areas like space security, space resilience and missile defense.

The proven innovative solutions we develop for government customers, grounded in our engineering expertise and mission knowledge, are also being applied to commercial opportunities, like our in-space satellite servicing. As part of our satellite servicing portfolio, we have developed the first commercial robotic spacecraft capable of repairing, relocating and servicing satellites in geosynchronous orbit via 2 robotic arms. It can also install life extension jetpacks onto other satellites for government or commercial customers, prolonging their useful life for up to 8 years. The spacecraft is known as the Mission Robotic Vehicle, or MRV, and our first MRV is scheduled to launch later today, weather permitting.

Before I turn the call over to John, I want to emphasize that we continue to see an opportunity-rich environment for our company. We're investing in our business, bringing continued rigor and program execution discipline, for which we're known, and we're moving with speed to bring innovative solutions to our customers. These innovations are core to the security of our nation, the protection of our allies and the preservation of freedom for generations to come. With growing demand, a robust backlog and disciplined execution, we are confident in our ability to deliver accelerated growth and enduring value for all our stakeholders. So with that, I'll ask John to provide a detailed review of our quarterly results and forward guidance.

John Thomas Greene
Corporate VP & CFO

Thank you, Kathy, and good morning, everyone. I'll begin by covering the company's second quarter financial results summarized on Slide 4. Overall, it was a solid quarter with increasing momentum. The robust demand environment we outlined on our last call continues to be converted into new bookings and sales. Second quarter awards totaled $20 billion, driving backlog up 17% year-over-year to $105 billion.

Sales in the quarter accelerated to $10.9 billion, with sequential sales up 10% and year-over-year sales up 5%. Segment operating income decreased slightly compared to the prior year. Keep in mind that second quarter of 2025 benefited from a $76 million favorable EAC adjustment on Sentinel. Earnings per share was $7.68, benefiting from a lower effective tax rate. Capital expenditures totaled $302 million and continued to ramp as we invest to expand our facilities to support customer demand. And Q2 adjusted free cash flow was nearly $1 billion, a significant increase compared to the prior year.

Turning to segment performance. I'll start with Aeronautics on Slide 5. AS delivered outstanding operational performance in the second quarter with double-digit sales and margin growth. Sales increased 13%, driven by higher volumes on B-21, TACAMO and mature production programs. On the bottom line, AS delivered a margin rate of 10.3%, driven by strong performance across production and sustainment programs.

Turning to DS. Second quarter sales increased 5% and 7% on an organic basis. Higher sales were driven by the continued ramp on Sentinel and missile defense programs. Operating margin was 7.5%. Strong performance across the portfolio was partially offset by a $68 million unfavorable adjustment on SiAW, related to an increase in projected cost to support the design and qualification of the system. Apart from SiAW, the rest of the DS portfolio contributed an OM rate of 11% in the second quarter, which gives us confidence in delivering improved returns in the second half. Backlog at DS increased to nearly $35 billion, driven by an increase of $7.6 billion on Sentinel.

Our Mission Systems business continued to generate outstanding bottom line performance, with strong execution across the portfolio. Sales were up 3% in the quarter, supported by higher volumes on marine programs, F-35 sensors and increases on restricted airborne radar programs. Margin rates improved to 15.4%, driven by strong performance and higher net favorable EAC adjustments across the business.

And at Space, sales increased by 4%, driven by higher volume on NASA's Commercial Resupply Services mission and missile defense programs. Second quarter operating margins were 8.6%. This included an unfavorable EAC adjustment on GEM 63XL related to increases in the estimated cost and quantity of materials needed to complete the program. The rest of the Space portfolio contributed an OM rate of over 11%, supporting our ability to deliver second half results north of 11%.

On Slide 9, you'll see our second quarter diluted EPS was $7.68. The prior period included a benefit of $1.04 associated with the Training Services divestiture. Normalizing for this transaction, Q2 EPS increased by $0.57. This improvement was largely driven by the remeasurement of uncertain tax positions given recent developments with the IRS and from a gain associated with the sale of an equity investment.

Turning to company level guidance on Slide 10. As Kathy outlined earlier in the call, we are increasing our sales guidance to a range of $43.75 billion to $44.25 billion. This outlook reflects a second half step-up in sales that is similar to the profile we experienced last year. With this in mind, we anticipate mid- to high single-digit year-over-year sales growth in Q3. We are increasing our markto-market adjusted EPS guidance to a range of $28.60 to $29.10, an increase of $1.20. This reflects solid segment performance in the second half and an effective tax rate of mid-14%.

We are reaffirming our outlook for segment operating income, which we are confident will improve in the second half. And we are reaffirming our guidance range for adjusted free cash flow of $3.1 billion to $3.5 billion. Adjusted free cash flow includes several hundred million dollars we expect to collect this year from the B-21 asset sale. This event accelerated cash receipts associated with the sale but shifted other payments on the program out beyond this year. Net-net, it doesn't change our expectations for 2026 cash on the program or the company.

Our adjusted free cash flow non-GAAP metric is consistent with our prior treatment from a few years ago when we had a similar event. We continue to expect $1.85 billion of CapEx in 2026. And as we previously shared, we expect CapEx investments of around 4.5% of sales in 2027 and 2028, as we invest in infrastructure to support the B-21 production ramp.

Turning to segment level guidance. At AS, we are increasing both our top and bottom line estimates for the year. We now anticipate sales of approximately $14 billion. This outlook reflects higher B-21 sales as the program continues to ramp, as well as higher volumes on mature production programs. On the bottom line, we are raising AS's operating margin rate to the mid- to high 9% range, reflecting strong performance in the first half of the year and continued positive expectations for the second half.

For DS, we are maintaining our outlook for sales in the mid- to high $8 billion range and margins of approximately 10%. Second half revenues are expected to step up more than $700 million, driven by higher ammunition sales and production timings in our weapons portfolio, as well as continued growth in Sentinel and IBCS. Second half margin rates are expected to improve to over 11%, consistent with our first half performance, excluding EACs associated with our missile prime investments.

At Mission Systems, we are maintaining our guidance of high $12 billion in 2026 sales, while raising our margin rate expectations to approximately 15%. This outlook is underpinned by a sequential second half sales increase of more than $600 million, driven by higher sales volumes on production programs and new awards.

Turning to Space. We continue to expect approximately $11 billion in sales for the year. Following the pattern in the other businesses, second half sales are expected to increase significantly. This growth is primarily driven by higher volumes on national security space programs, new awards and improved performance on GEM 63XL. On the bottom line, we are lowering our expectation for margin rate to the low 10% range, to reflect the margin pressure experienced to date. Performance remains strong across the majority of the Space portfolio, and we're confident in delivering improved second half performance.

Our last guidance update for the quarter relates to intersegment eliminations, which we expect to be approximately $2.7 billion, driven by increased volumes of restricted work at MS and Sentinel support in the Space segment. We anticipate the intersegment OM rate to be in the mid-13% range.
In summary, building on the momentum established in the first half, we remain on track to deliver on our updated full year projections. Our confidence is underpinned by the enduring demand for our capabilities, record backlog and alignment of our portfolio to global defense priorities. We've made significant investments in our business that position the company for accelerated growth, and we continue to be disciplined in our capital deployment strategy, creating value for all of our stakeholders. With that, let's open the call for Q&A.

Question and Answer

Operator

[Operator Instructions] And our first question comes from Ron Epstein with Bank of America.

Andrew Steinhardt
BofA Securities, Research Division

Kathy, John and Todd, congrats on the quarter. This is [Andrew] on for Ron. Just unpacking the tax impact from the quarter. Is the $1.20 EPS increase in the updated full year guidance driven entirely by a combination of lower taxes in the quarter and higher sales expectations for the year?

John Thomas Greene
Corporate VP & CFO

Yes. Thanks for the call. I'll take it. This is John, by the way. So the tax had an impact on the quarter, certainly. But the higher EPS for the year will be driven by sales execution, increasing sales, strong second half margins, certainly a tax benefit, and we're going to continue to kind of manage the operating cost in the business to ensure that we're as efficient as possible.

So it's a balance of factors, certainly, in the current quarter as we did make that adjustment to the uncertain tax position. It did pull forward a benefit. But really, what we're trying to get across on this call, is the operations are strong, and we expect to deliver a really strong second half of the year.

Andrew Steinhardt
BofA Securities, Research Division

Got you, that's very helpful color. And I guess just pivoting in a different direction here. Relating to the unfavorable EACs on Stand-in Attack Weapon, what exactly is driving the higher expected development costs on that program?

Kathy J. Warden
Chair, CEO & President

[Andrew], as we mature production on the AARGM-ER program, which is the basis of the technology for Stand-in Attack Weapon, we have had some delays in testing that have resulted in a flow-through to the schedule for design and qualification on the Stand-in Attack Weapon. So we look at those 2 programs collectively as part of our tactical missile growth strategy.

And we've been investing in more resources to the team, including better integration lab facilities, so that we can accelerate through the testing and to be able to deliver these capabilities. They're very much in high demand. One program's for the U.S. Navy, the other for the U.S. Air Force, and we have international customers that are looking to get these missiles in their hands. So we want to make sure that we're doing everything we can to drive through the performance challenges and deliver.

Operator

Our next question comes from Seth Seifman with JPMorgan.

Seth Michael Seifman
JPMorgan Chase & Co, Research Division

Maybe a little bit bigger picture question about investment. Northrop's invested, I think, more than peers over the past decade. Can you talk a little bit more about the returns you've seen on that investment, how it kind of compared to your targets, and how you think about the return on investment for the increased CapEx moving forward? And maybe how that compares to what you've looked for historically?

Kathy J. Warden
Chair, CEO & President

Seth, I'll start. I look at the investments that we've made in the last several years as both investing in capability for new product lines. We've talked about 2 already this morning, GEM 63XL and Stand-in Attack Weapon are good examples of those investments in capability, but also what we've invested in programs like the B-21, our offerings for Golden Dome, all really position us for that increased top line growth that we are starting to see.

And as I talked about earlier on the call, we now expect book-to-bill this year to be 1.25. I see that as a direct correlation to the investments that we have made in capability. We also have been investing in capacity, and that has positioned us to win work that we otherwise wouldn't have been in a position to deliver upon. Good examples of that are in the munitions portfolio. I talked about having qualified on PAC-3 MSE, but we also have production capacity so that we can start building right away. That allows us to pull those revenues in sooner than we otherwise would, had we not made those investments.

So we are consistently investing with discipline, making sure that we have strong business cases, that those then are coming to fruition. Our programs are not without technical risk. But once we get through development, having that production in place is serving us well to generate strong returns and accelerate the revenue and return.

Seth Michael Seifman
JPMorgan Chase & Co, Research Division

Great. Great. And maybe just one more detailed question about HALO. I think the release mentioned some revenue pressure from that program. Is that related to timing? Or is that related to the NASA decision to move away from Gateway? And if that's the case, are there further sales pressure from HALO expected that we should be aware of?

Kathy J. Warden
Chair, CEO & President

So as you noted, NASA is moving away from their original Gateway plans. We are working with NASA to take the technology that we were developing under the HALO program and still have that contribute to their future Gateway plans. And so we are in the process of restructuring the contract to do that. It will reduce revenue this year as we outlined in our filings, but it will extend it over a longer period of time as we work deliverables into the new NASA plan.

Operator

Our next question comes from Sheila Kahyaoglu with Jefferies.

Sheila Karin Kahyaoglu
Jefferies LLC, Research Division

Maybe Kathy, just on the last line of questioning, can you talk about, you know, you recently completed qualification activities on solid rocket motors for PAC-3? Maybe on PAC-3 and more broadly on the missile framework, how you're thinking about the timing. Is that in line with plan? How we think about capacity expansion? And how that impacts profitability?

Kathy J. Warden
Chair, CEO & President

Yes, Sheila. So as I noted, we first needed to get through qualification, which we did in this quarter. We have production capacity, and we are starting to build. And we are doing that even ahead of definitized contract later this year, so that we can support the increased demand for the program. We do expect to be definitized for a larger production contract later this year as the funding becomes available through the appropriations from the FY '27 budget.

Sheila Karin Kahyaoglu
Jefferies LLC, Research Division

Got it. And as we think about -- within DS, as you think about your drivers in the second half, that's mainly Sentinel and the weapons programs coming into fruition?

Kathy J. Warden
Chair, CEO & President

Yes. Although I will say that we are seeing strength in top line across all 4 of our businesses as you compare first half to second half. Some of that is just the natural seasonality of the businesses that we saw last year. We have achieved 5% growth in each of the first 2 quarters over last year and expect that same trend in the second half to get to the midpoint of our guidance of 5%. But as you know, last year, it was an accelerating growth through the year, and we are expecting that same trend to occur this year.

Operator

Our next question comes from Gavin Parsons with UBS.

Gavin Eric Parsons
UBS Investment Bank, Research Division

Kathy, on B-21, as you progress sort of expanding the production capacity there, have you had any additional conversations with customers about increasing the program of record beyond 100 units?

Kathy J. Warden
Chair, CEO & President

The agreement we reached with the Air Force does allow them to consider accelerating production into a larger program of record. And we are working with them in that analysis, they are undertaking it now. I expect that by year-end, they will come to a conclusion on that, and we'll certainly keep you updated.

Gavin Eric Parsons
UBS Investment Bank, Research Division

Okay. And then on Aero margins, can you just give us a little bit more detail on if that strength has been better B-21 performance, legacy programs, a mix of both?

John Thomas Greene
Corporate VP & CFO

Yes. Thank you. It's been a mix. Certainly, B-21, there's been good execution throughout the year, so that's been an enabler to ensure the overall program profitability remains on a direction that's headed north. And then mature production programs, EACs, have been favorable across the board. So what I would say is kind of the manufacturing processes and delivering to key milestones has been strong within this segment, which has enabled margins to be stable and on an upward trend.

Operator

Our next question comes from John Godyn with Citi.

Jeremy Elliot Jason
Citigroup Inc., Research Division

This is Jeremy Jason on for John Godyn. I just kind of wanted to ask -- so since we last spoke, we saw the largest IPO in history. So from a space perspective, what's your overall broad assessment of demand for space as it relates to defense?

Kathy J. Warden
Chair, CEO & President

Thanks, Jeremy. So in my prepared remarks, I talked a bit about our Space business and the fact that particularly with national security space, inclusive of our space resiliency offerings, our intelligence surveillance and reconnaissance efforts as well as missile defense. We are seeing that as one of the strongest areas, not only of U.S. budget growth, but also our own projected growth as we look out through the remainder of this year and into next.

And we see it growing to be a more sizable part of our overall portfolio, generating about 15% of the revenues for the company as that area grows double digits. So we definitely see that space, as a marketplace in the U.S., is growing. I will also note, we are starting to see increased demand internationally for space as well. Different offerings there, obviously, from an export perspective, but we have a growing pipeline outside the U.S. for our space portfolio, too.

Jeremy Elliot Jason
Citigroup Inc., Research Division

Awesome. That's really, really helpful. And as a quick follow-up, can you go over your plans for MRV and your involvement in these more commercial markets?

Kathy J. Warden
Chair, CEO & President

Yes. So our MRV offering is part of our larger satellite servicing market that we have been operating in to provide life extension to satellites. This offering brings robotic arms that allow us to do more servicing operations for satellites. We expect both commercial and government clients to be interested in this capability because, as I noted, it's about extending the life of these high-value assets and being able to do that and reduce maintenance and replenishment costs.

So this is an area where we have taken a commercial model, meaning we've invested, we will deploy the capability. And in 2027, it will become operational. It takes us a while to get it into the right orbit and to test it and begin servicing, but we, next year, expect this to be a part of our service offerings.

Operator

Our next question comes from Scott Deuschle with Deutsche Bank.

Scott Deuschle
Deutsche Bank AG, Research Division

Kathy, would you be able to share any detail with respect to what your market share on this upcoming PAC-3 contract might look like? Is this a small share position you're pursuing? Or do you see a path for Northrop to play a substantial role in this program?

Kathy J. Warden
Chair, CEO & President

So Scott, at first, because we are a brand-new supplier, we will start at a smaller scale, and that will grow over time. I'm not at liberty to share exact quantities with you, but just sufficient to say, we are focused on performing in these early production deliveries and believe that in doing so, that will gain us the credibility to continue to scale.

Scott Deuschle
Deutsche Bank AG, Research Division

Okay. And then John, consensus is forecasting about a 7% revenue CAGR at Defense Systems over the next 3 years. I guess just as you look across the segment, across all of these awards you got this quarter, the growth in Sentinel, IBCS, international, do you see a path to deliver growth better than that 7%?

John Thomas Greene
Corporate VP & CFO

Yes. So I'm going to talk about the current year and then try to refrain from giving too many details on the outer years, largely because we've worked through the strategic plan, and we've got some more details to do to kind of firm out the outer years. But what I will say is the execution in the quarter on the strong book-to-bill, the execution last year on the book-to-bill and the marquee program, Sentinel, B-21, weapons demand, all provide growth drivers that should enable the company, over time, to accelerate revenue relative to what it's done historically.

Operator

Our next question comes from David Strauss with Wells Fargo.

David Egon Strauss
Wells Fargo Securities, LLC, Research Division

I guess a follow-up there. Kathy, I think in some recent public forums, you've spoken of an acceleration in growth at Space next year, as well as MS, where the growth is relatively low this year. So taking that, with what I would assume to be pretty strong growth still at DS and AS as we move into '27, I mean, is it possible that revenue growth could be in the high single-digit range next year?

Kathy J. Warden
Chair, CEO & President

So -- as John said, we're going to refrain from putting a number around 2027 growth, but we are outlining reasons for optimism. You heard in the call the book-to-bill of 1.25. We've talked about the international growth being double digit. We have spoken about not only those tailwinds to top line, but also tailwinds to margin as we start to shift mix away from mostly development to more production, and those being the key drivers of our higher-margin performing businesses this year.

So really a lot to be optimistic about as we look forward to 2027. And I will also note the budget for the U.S. has our programs very well supported in the base budget. So we're not dependent on significant supplemental or incremental funding above the base budget to drive that growth into 2027.

David Egon Strauss
Wells Fargo Securities, LLC, Research Division

Okay. And then as a follow-up, I guess, pivoting over on the free cash flow side of things, you've obviously highlighted a little bit higher CapEx profile than maybe you were thinking a bit ago when you originally gave the '27, '28 forecast for free cash flow. If you could just update us kind of on your thoughts there, and whether that prior guidance holds even with the higher CapEx profile.

John Thomas Greene
Corporate VP & CFO

Yes. Thanks for that. So I'm going to go back to kind of operating cash flows first and talk about that. So from '23 through the current year, operating cash flows have increased about 30%. So the business continues to generate cash, and a great deal of cash, quarter-over-quarter. As we look at the outer years in terms of free cash flows, so what we tried to do is give a view on CapEx, that 4.5% of sales.

We're going to continue to work that and manage that in order to turn that operating cash flow into free cash flow. So the '27 and '28 numbers, and then beyond, we're going to continue to refine that through this quarter, and then we'll be prepared to give a view, third quarter, and then an updated view in the fourth quarter. I do want the audience to recognize that we understand how important free cash flow is for our investors.

And the fact that we use that free cash flow effectively. We're investing to support our customers' demand right now, and we'll continue to do that. And at the right time, we will begin to evaluate the CapEx spend to make sure it makes sense. But right now, first and foremost, is continue to invest to meet the demand signals that we're seeing.

Operator

Our next question comes from Matt Akers with BNP Paribas.

Matthew Carl Akers
BNP Paribas, Research Division

Kathy, I wanted to ask about unmanned demand. We saw the recent order from NATO for Triton. Just curious what you're seeing there and that could be a contributor to -- trying to double the international business as you talked about.

Kathy J. Warden
Chair, CEO & President

Yes. We are very pleased that NATO has expressed interest in buying up to 5 Tritons. We expect to work with them throughout the remainder of this year to get on contract next. And we see this as an endorsement for products like Triton, that are mature production programs that we can deliver off of our production line with relative speed and being able to support a very important mission of surveillance in the High North.

We do see our unmanned systems continuing to contribute to our overall company international growth, but we have numerous growth drivers internationally. I talked on this call about munitions, IBCS. We have talked also about other platforms, like E-2D, manned platforms that are driving international demand at the moment. So it really is a broad-based set of international offerings that we see driving that overall growth that I spoke to earlier on the call.

Matthew Carl Akers
BNP Paribas, Research Division

Yes. Great. And if I could do one more, I guess, is it possible to give us any update on what's going on with Golden Dome? And I know you guys are working on the space-based interceptors, but any thoughts on how that's going? And I don't know if it's possible to quantify how much that's contributing for this year.

Kathy J. Warden
Chair, CEO & President

So Golden Dome, as you know, is a collection of programs that create our homeland missile defense architecture. And so it is a series of competitions, as well as sole source additions to contracts that we already have in place. We started to see reconciliation dollars be allocated earlier this year.

I spoke to that on our first quarter call that, that was somewhat slow coming into the year, but opened up as we entered into the second quarter, and we are seeing those funds be put onto contract. We expect that, that'll continue to be the case, and that we will see more selection decisions and contract actions throughout the remainder of this year and into early next. So revenues from Golden Dome-related activity will continue to scale.

Operator

Our next question comes from Justin Lang with Morgan Stanley.

Justin M. Lang
Morgan Stanley, Research Division

This is Justin on for Kristine this morning. I wanted to ask one on the microelectronics business. Kathy, you've given some great color in the past around this business and the work you're doing at the foundry. So I was just hoping you could update us on how that business is faring and how the growth outlook there might compare to the rest of the MS portfolio given both internal and external demand.

Kathy J. Warden
Chair, CEO & President

Yes. Thanks for the question. So we do continue to, in that business, offer both solutions for governments and commercial customers. We are experiencing some program life cycle dynamics, so growth in that business has been lower this year, particularly in our restricted microelectronics area, but we expect demand to increase over time, as we've spoken about. This is an important enabler, not only to our products, where we vertically integrate these microelectronics into offerings in MS, Space and Aeronautics, as well as weapon systems in DS, but also where we sell them to other customers who rely on them for secure processing in a wide range of product lines. So that underlying demand that is fueling the microelectronics business is still robust. It's just a bit of a temporary year-over-year compare after growing very strongly last year, growing less so this year.

Operator

Our next question comes from Scott Mikus with Melius Research.

Scott Stephen Mikus
Melius Research LLC

John, I just had a quick question. I appreciate the color on what gives you line of sight to low 11% margins at both DS and Space in the second half of this year. Is that low 11% margin rate for both those segments the right jumping off point for 2027?

John Thomas Greene
Corporate VP & CFO

Yes. We're focused on 2027, and I get it. I will say this, that the businesses have really strong backlogs. We're working through, kind of, the one program issue at DS. You pull that out and those margins are about 11%. And then we've given a fair amount of detail on the rest of the segment. So I'm not going to suggest how exactly you model, but what I will say is we have confidence in the execution capabilities of the firm and the ability to continue to drive strong margins through the second half of this year and into next year.

Scott Stephen Mikus
Melius Research LLC

Okay. And then a quick one for Kathy. On MRV, you probably can't provide quantitative terms here. But just from a qualitative perspective, what's the potential market for an offensive version of that spacecraft that could be used to disable adversary satellites?

Kathy J. Warden
Chair, CEO & President

I appreciate the question. I will leave it up to the U.S. government to decide how that capability might fulfill mission objectives that they have, in that regard. But certainly, it's our objective to offer our clients options for technology deployment and for them to determine policy for when and how they might deploy that technology.

Operator

Our next question comes from Andre Madrid with BTIG.

Andre Madrid
BTIG, LLC, Research Division

I know you mentioned marine as a growth driver at Mission Systems. This is not part of the business that I think often gets highlighted. Looking at also recent M&A activity amongst peers in this space, what more can you share about your marine business today and maybe where it's going? Is this a mission area in which you might look to invest more organically or inorganically?

Kathy J. Warden
Chair, CEO & President

So we do have exposure to multiple aspects of the marine marketplace. The one that we talk about most is the work we're doing on propulsion for the modernization of the nuclear Navy. And that is the biggest growth driver in our marine business and expect it to continue to be so as we move through what are the early stages, just delivering on our first low-rate initial production unit, to scale that over time and continue to produce throughout this and the next decade.

So we are really pleased that, that set of programs has come out of development and now is in production. Our team is executing very well to drive schedule improvement and be able to improve our overall performance, thus our margins on that business. And we expect it not only to be a key growth driver, but also a key performance driver for the foreseeable future.

Andre Madrid
BTIG, LLC, Research Division

Got it. Got it. That's really helpful. And then maybe broadening to the international pipeline, can you give us more color there? I know you mentioned the Kuwait order. Maybe how is the Middle East looking as a broader market? And on that same note, are you seeing any meaningful reforms occurring around the FMS process that can hopefully speed that up?

Kathy J. Warden
Chair, CEO & President

Yes. So we announced the Kuwait order, as you said, for the 6 systems in this quarter. We also have a letter of request in from UAE and Qatar for our IBCS system, and we're in discussions with multiple other Middle East countries. All of this is a result of the importance of missile defense as demonstrated in the recent conflicts for cruise missiles and drones, both detection and interception, and of course, the IBCS product line is designed for that exact short- and medium-range integrated air and missile defense mission. So we expect that to continue.

With regard to how quickly we're able to progress FMS cases, we've seen a real improvement there. FMS cases are being approved at a much more rapid rate. We're significantly ahead of what we experienced in prior years. And I appreciate the focus that this administration has put on the cross-agency work that goes into expediting those FMS cases.

Operator

Our next question comes from Peter Arment with Baird.

Peter J. Arment
Robert W. Baird & Co. Incorporated, Research Division

Kathy, on the Defense Systems' EAC adjustment and investment spending on tactical missiles, I mean, how do you handicap kind of the cost growth from here? I mean would you characterize it like we're in the mid-innings, late-innings and just confidence around the double-digit margin guidance for the second half of the year for DS?

Kathy J. Warden
Chair, CEO & President

Yes. So I appreciate the question, and we have brought in independent resources to really scrub our assumptions that sit behind that EAC. So I do have confidence that we have a plan that is executable and the team in place. We've added resources, as I said earlier, not just people resources, but infrastructure, to allow us to execute that plan, and we have had agreements with our customer that give me confidence that we are in lockstep with them on what needs to be delivered.

So those risks being well understood is generally the key to being able to have confidence in the go-forward plan and the estimated costs, and we are there. With that said, we are not done (sic) [done with] the qualification, until we are there is risk, but we will continue to keep you updated. And I feel very confident that we have a good plan to execute.

Operator

Our next question comes from Gautam Khanna with TD Cowen.

Gautam J. Khanna
TD Cowen, Research Division

I was wondering if you could elaborate on the $10 billion of SRM opportunity over 7 years, and how we should think about the company's protection against inflation, how we should think about pricing on that as you price out so long and what that might mean for the profitability of that business over time?

Kathy J. Warden
Chair, CEO & President

Yes, Gautam, thank you for the question. Those negotiations are ahead of us. What we have now is a set of opportunities, and we are working with our respective Department of War and prime customers to identify what those negotiation points of price and fee will be and the investments that we need to make and the recovery of those over time. The framework agreements lay out a construct for those.

And then as we work through this year, and as I noted, probably even into early next, as funding becomes available, we'll work through the finer points to definitize contracts. I assure you, we will work with discipline as we do on all of our contracts. In many cases, we have invested so that we have capacity available now. And we have gotten through qualification, which means we understand what we need to build, and these will look more like mature production programs, but we will ensure that we incorporate any risk that we have into our assumptions for pricing.

Operator

And our final question comes from Myles Walton with Wolfe Research.

Myles Alexander Walton
Wolfe Research, LLC

John, I just wanted to ask about the size of the positive adjustment on Sentinel in the quarter. Was that effectively offset by the higher investment in AARGM, and that's why we should be thinking about the 11% ex the Stand-in weapon?

John Thomas Greene
Corporate VP & CFO

That's good analysis, is what I would say on that. So it wasn't material enough to break out separately, so we didn't want to create a precedent on identifying low-dollar items because it just probably wouldn't stop. So we kept to the precedent. But as you described, a good way to think about it.

Myles Alexander Walton
Wolfe Research, LLC

Okay. And then, Kathy, on Space, the largest new start program in the fiscal '27 submission was space-based AMTI, and then SpaceX subsequently quickly got a $4 billion award on that program. Can you describe where Northrop is planning to compete, either as a prime or a supplier within space-based AMTI or GMTI space-based?

Kathy J. Warden
Chair, CEO & President

So as you note, it is an attractive segment of the market, where we do have capability. We are looking at future tranches of requirements that we would be able to be responsive to. We won't get out ahead of ourselves on any decisions with regard to bids at this point, but it is a market that we believe we have opportunity to play in.

Well, thank you all for joining our call today. As you've heard from both John and I, we see the robust demand for our products around the globe, and we are optimistic. As we sit here today, that U.S. budgets will continue to fully support our programs. We are also confident that we are on a path for improved margin performance in the second half, and we recognize how important that is.

Our team is fully committed to addressing the 2 program items that we spoke about today and delivering strong performance on those in the second half, while continuing the excellent performance that we had in the rest of the portfolio with company margins nearing high 11s without those 2 EAC adjustments. And that performance needs to continue, and we are committed to making it so that we can drive the increase in sales and EPS that we've committed to in our updated guide. So thanks again for joining our call. John and Adam look forward, as always, to following up with you on any additional questions that you have.

Operator

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