Raytheon Company (RTN)

Updated May 10th, 2018 by Nate Parsh

Key Metrics

Current Price:	$212	**5 Year CAGR Estimate:**	-0.6%	**Quality Percentile:**	N/A
Fair Value Price:	$138	**5 Year Growth Estimate:**	6.0%	**Momentum Percentile:**	N/A
% Fair Value:	154%	**5 Year Valuation Multiple Estimate:**	-8.2%	**Total Return Percentile:**	N/A
Dividend Yield:	1.6%	**5 Year Price Target**	$184	**Valuation Percentile:**	N/A

Overview & Current Events

Raytheon Company was founded in 1922. The company's first product was the S gas rectifier tube, which eliminated expensive batteries found in home radios. Today, Raytheon is the fifth largest military contractor. The company provides missile, electronic, radar and communication systems to the United States and its allies. Raytheon has four divisions: Integrated Defense Systems, Intelligence Information and Services, Missile Systems and Space and Airborne Systems. Raytheon has a current market cap of $61 billion and had a company record $25.3 billion in sales in 2017.

Raytheon reported earnings for the 1st quarter of 2018 on 4/26/2018. The company earned $2.20 per share, beating estimates by $0.09. Revenue grew 5% year over year to $6.3 billion. Each division saw an improvement in sales, led by Integrated Defense Systems' 7% growth. The company now expects EPS for 2018 in the range of $9.70-$9.90, up from $9.55-$9.75. Raytheon forecasts sales for the year to be between $26.5-$27 billion, up from $26.4-$26.9 billion. The company's backlog stands at $38.1 billion, almost 6% higher than the total for Q1 2017.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	$3.95	$4.89	$4.79	$5.28	$5.65	$5.96	$6.97	$6.75	$7.44	$6.94	***$9.80***	***$13.11***
DPS	$1.12	$1.24	$1.50	$1.72	$2.00	$2.20	$2.42	$2.68	$2.93	$3.19	***$3.47***	***$4.64***

Raytheon's earnings per share growth rate over the past decade is almost 6% per year. The company actually experienced earnings growth in both 2008 and 2009, a time where many companies struggled with increasing their bottom lines. Based off of the midpoint of the company's updated guidance for this year, shares of Raytheon could earn $13.11 by 2023.

One major catalyst for the Aerospace and Defense sector is the amount of funding the governments of the world are currently providing for defense products. The U.S. spent $589 billion on defense in fiscal 2017, an increase of $9 billion from the previous year. For fiscal 2018, that figure jumped to $700 billion. In February, leaders of both political parties agreed to a spending deal that add another $165 billion in defense spending over the next two years.

Raytheon has increased its dividend for the past 14 years. Over the past decade, the annual growth rate has been 12%. The most recent raise hiked the dividend 8.8%. It is our view that dividends should increase by at least the same rate as earnings going forward. If this is the case, then shareholders could receive at least $4.64 per share by 2023.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	14.8	9.4	10.6	8.9	9.5	11.7	14.0	16.2	18.0	24.2	***21.5***	***14.0***
Avg. Yld.	1.9%	2.7%	3.0%	3.7%	3.7%	3.2%	2.5%	2.5%	2.2%	1.9%	***1.6%***	***2.5%***

Shares of Raytheon have traded with a price to earnings multiple below 14 for most of the past ten years. Only in the last three years has the P/E expanded beyond this range. After gaining more than 32% in 2017, the stock's multiple has ascended to new highs. Based off of EPS expectations for this year, shares current trade with a multiple of 21.5. Given the reliance Raytheon has on the U.S. government for revenue, we assign a target P/E of 14 for shares. If the stock were to revert to this P/E, the multiple would contract 8.2% per year.

Raytheon's share price stagnated in the early to middle of the current decade. Shareholders were paid an attractive dividend yield during this time. As the stock price accelerated, that yield has shrunk. The current yield is below that of both the S&P 500 and the 10-Year Treasury Bond. Management believes that the company could produce as much as $4 billion in free cash flow in 2018, up from $2.7 billion last year. Higher dividend growth could be a result of this growth.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	20.3%	21.7%	20%	19.8%	19.9%	19.9%	20%	19.5%	20.4%	20.3%	***20.3%***	***20.3%***
Debt/A	60.3%	57.9%	59.5%	67.7%	69.3%	56.9%	64.9%	64.7%	66.4%	67.7%	***66.9%***	***63.5%***
Int. Cov.	40.8	28	22.5	17.9	15.5	15	15.7	13.8	15.4	18	***18.5***	***20.3***
Payout	28.4%	25.4%	31.3%	32.6%	35.4%	36.9%	34.7%	39.7%	39.4%	46%	***35.4%***	***35.4%***
Std. Dev.	25.5%	37.4%	17.3%	22.6%	14.4%	20.4%	14.6%	19.1%	12.3%	9.1%	***11.2%***	***19.3%***

Raytheon showed earnings growth during the last recession, something not every company can say. Given strong global demand for products, this should continue as long as the world's economies are on solid ground.

Raytheon has produced a very consistent gross profit to asset ratio over the last 10 years. Given spending levels for defense products, Raytheon is in a very good position to maintain their profitability, perhaps even improve upon this metric. The company has seen a rise in debt as a percentage of assets has increased slightly over the past ten years, but not yet to an unmanageable level.

The dividend payout ratio has been below 40% for much of the past ten years. Even with double digit dividend growth, the payout ratio has stayed very low. This low ratio affords Raytheon a cushion if earnings enter a period of decline. Dividend growth investors should feel comfortable in Raytheon's ability to continue to grow its dividend.

Final Thoughts & Recommendation

Shares of Raytheon have gains of more than 45% since the beginning of 2017. This share price growth has reduced our expected total returns over the next five years. We forecast that Raytheon would off annual returns of -0.6% through 2023 based on a combination of growth (6%), dividends (1.6%) and multiple reversion (-8.2%). Shares of Raytheon are trading at a steep premium to their historical multiple. We suggest that investors wait for a better entry point as there are better options to choose from in the aerospace and defense sector.

Total Return Breakdown by Year