Northrop Grumman (NOC)

Updated June 15th, 2018 by Nate Parsh

Key Metrics

Current Price:	$325	**5 Year CAGR Estimate:**	5.5%	**Quality Percentile:**	N/A
Fair Value Price:	$239	**5 Year Growth Estimate:**	10.0%	**Momentum Percentile:**	N/A
% Fair Value:	136%	**5 Year Valuation Multiple Estimate:**	-6.0%	**Total Return Percentile:**	N/A
Dividend Yield:	1.5%	**5 Year Price Target**	$395	**Valuation Percentile:**	N/A

Overview & Current Events

Northrop Aircraft was incorporated in 1939 and the company built its first aircraft, a patrol bomber for the Norwegian Air Force, in 1940. The company's B-2 stealth bomber took its first flight in 1989. In 1994, Northrop purchased Grumman Corporation, builder of the Lunar Module that landed on the moon in 1969. Today Northrop Grumman has a market cap of $56 billion and produced almost $26 billion in revenue in 2017.

Northrop Grumman reported 1st quarter earnings on April 25th. The company earned $4.21 per share, a massive $0.57 beat of estimates. EPS improved 14% from Q 2017. Revenue grew 5.1% to $6.74 billion. This topped estimates by $130 million. The first quarter was so strong that Northrop Grumman increased the midpoint of its guidance for 2018. The company saw its effective tax rate in the quarter decline 2.3% year over year to 15.2%.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	$5.32	$4.87	$5.80	$7.41	$7.81	$8.35	$9.75	$10.39	$12.19	$11.47	***$16.33***	***$26.30***
DPS	$1.57	$1.69	$1.84	$1.97	$2.15	$2.38	$2.71	$3.10	$3.50	$3.90	***$4.70***	***$7.57***

Northrop Grumman's earnings declined somewhat during the last recession, but the company quickly rebounded to growth in 2010. Except for 2017, earnings have increased every year since over the last decade.

On September 18th of last year, Northrop Grumman agreed to purchase Orbital ATK for $9.2 billion. Orbital ATK is the largest supplier of ammunition to the U.S. government and has contracts with NASA to provide the rockets used to travel to the International Space Station. While this acquisition will add to the Northrop Grumman's debt level, long term Orbital ATK will be an earnings boon to the company. The combined backlog of the two companies totals more than $60 billion. On June 6th, Northrop Grumman updated its guidance a second time for 2018, this time to reflect Orbital ATK. The company now sees earnings per share reaching a midpoint of $16.33 and sales of $30 billion. Both figures are well above analysts' expectations. With Orbital ATK in the fold, we project earnings could grow 10% per year through 2023, slightly above the company's 10-year average of 8% EPS growth.

Another factor working in Northrop Grumman's favor is that governments are increasing defense spending levels. In the U.S., the government spent $700 billion on defense in fiscal 2017 and aims to increase that in fiscal 2018.

Northrop Grumman has increased its dividend every year for the past 15 years. The average raise over the last 5 years has been 12.6%. The company raised its dividend 9.1% on May 15th. We expect that dividend growth will at least mirror earnings growth going forward. Northrop Grumman is very shareholder friendly company. In addition to solid dividend increases, the company is continuously buying back shares of its own stock. The share count has been reduced at an average rate of 6.3% per year since 2008.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	12.4	9.9	10.5	8.3	8.2	10.4	12.9	16.1	17.4	23	***20.4***	***15***
Avg. Yld.	2.4%	3.5%	3.0%	3.2%	3.4%	2.7%	2.1%	1.9%	1.6%	1.5%	***1.5%***	***1.9%***

Northrop Grumman's price to earnings multiple has risen significantly in recent years. Shares now trade with a P/E north of 20, which is in line with many of the company's peers. The stock's 10-year average multiple is 12.9. Given Northrop Grumman's back log, purchase of Orbital ATK, share repurchases and increased spending on defense by the U.S. government, we feel the stock deserves to trade at a slight premium to its historical valuation. If shares were to revert to our target P/E of 15, shares would see a multiple contraction of 6% per year through 2023.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	19.7%	18.6%	16.8%	22.1%	21%	20.4%	21.1%	23.1%	22.6%	17.1%	***17.7%***	***20.2%***
Debt/A	60.5%	58.1%	56.9%	59.3%	64.2%	59.7%	72.8%	77.4%	79.5%	79.8%	***82%***	***66.8%***
Int. Cov.	-0.8	9.1	5.3	15	15	12.1	11.4	10.3	10.7	9.5	***9.5***	***9.8***
Payout	29.5%	34.7%	31.7%	26.6%	27.5%	28.5%	27.8%	29.8%	28.7%	34%	***28.8%***	***28.8%***
Std. Dev.	34.9%	36.8%	20.1%	27.9%	14.5%	17.7%	14.2%	15.8%	15.7%	10.2%	***12.3%***	***20.8%***

Northrop's debt as a percentage of assets has increased steadily in the last few years. With the purchase of Orbital ATK and borrowing capital to reduce the share count, debt is at a very high level. That being said, only 27% of Northrop's debt is due within the next 5 years and the company's interest payments are well covered. Northrop Grumman has a very low payout ratio which should give shareholders comfort that the company would be able to maintain its dividend even in the event of a prolonged recession.

Final Thoughts & Recommendation

Investors who have held Northrop Grumman shares from the beginning of 2017 have seen its stock price return almost 38%. This gain has absorbed much of the stock's expected total return going forward. We believe that shares could offer a total return of 5.5% per year through 2023. This expected return is a combination of growth (10%), dividends (1.5%) and multiple contraction (6%). Except for Boeing (BA), this total return is higher than most of Northrop Grumman's peers in the Aerospace and Defense sector. Despite this, Northrup Grumman looks significantly overvalued today. Investors should wait for a better entry point before initiating a position in Northrup Grumman.

Total Return Breakdown by Year