Raytheon Company (RTN)

Updated August 7th, 2018 by Nate Parsh

Key Metrics

Current Price:	$197	**5 Year CAGR Estimate:**	2.3%	**Volatility Percentile:**	7.3%
Fair Value Price:	$148	**5 Year Growth Estimate:**	6.0%	**Momentum Percentile:**	60.1%
% Fair Value:	133%	**5 Year Valuation Multiple Estimate:**	-5.5%	**Valuation Percentile:**	13.7%
Dividend Yield:	1.8%	**5 Year Price Target**	$198	**Total Return Percentile:**	10.9%

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 $56 billion and had a company record $25.3 billion in sales in 2017.

Raytheon reported 2nd quarter earnings on July 26th. The company earned $2.78 per share, $0.43 ahead of estimates and a 47% improvement year over year. $0.33 of EPS totals was directly related to 2017 tax reform legislation. Excluding this, EPS still improved 30%. Revenue grew 5.6% to $6.63 billion, topping estimates by $120 million.

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	***$9.88***	***$13.22***
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 experienced earnings growth in both 2008 and 2009, a time where many companies struggled with increasing their bottom lines.

Almost every division of Raytheon saw an increase in revenue during the 2nd quarter. Missile Systems, the company's largest source of revenue in the quarter, led the way with an 8% sales increase, as net sales on classified programs increased compared to the previous year. Intelligence Information and Services also had 8% revenue growth as several of the company's classified program saw high demand. Defense Systems saw a modest sales growth of 4%. Raytheon's Patriot program continues to see high demand, both in the U.S. and internationally. Space & Airborne Systems was the lone division to see a revenue drop, though this decline was just 0.1%. In total, Raytheon booked $8.7 billion worth of deals during the quarter, driving the company's backlog to a record $39.9 billion. Due to 2nd quarter results, Raytheon increased the midpoint of its earnings forecast to $9.88 from $9.80 previously.

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. alone 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 (on March 21st) increased the dividend 8.8%.

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	***19.9***	***15.0***
Avg. Yld.	1.9%	2.7%	3.0%	3.7%	3.7%	3.2%	2.5%	2.5%	2.2%	1.9%	***1.8%***	***2.3%***

Shares of Raytheon have declined $15 dollars, or 7%, from our May 10th update. Based off of updated guidance, the stock has a forward P/E of 19.9. Due to company results and increases in spending on defense, we have raised our 2023 target P/E to 15 from 14. If shares of Raytheon were to revert to this new target, the stock could have multiple contraction of 5.5% per year, down from an 8.2% annual contraction in our previous update.

Raytheon's share price stagnated in the early to middle part 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

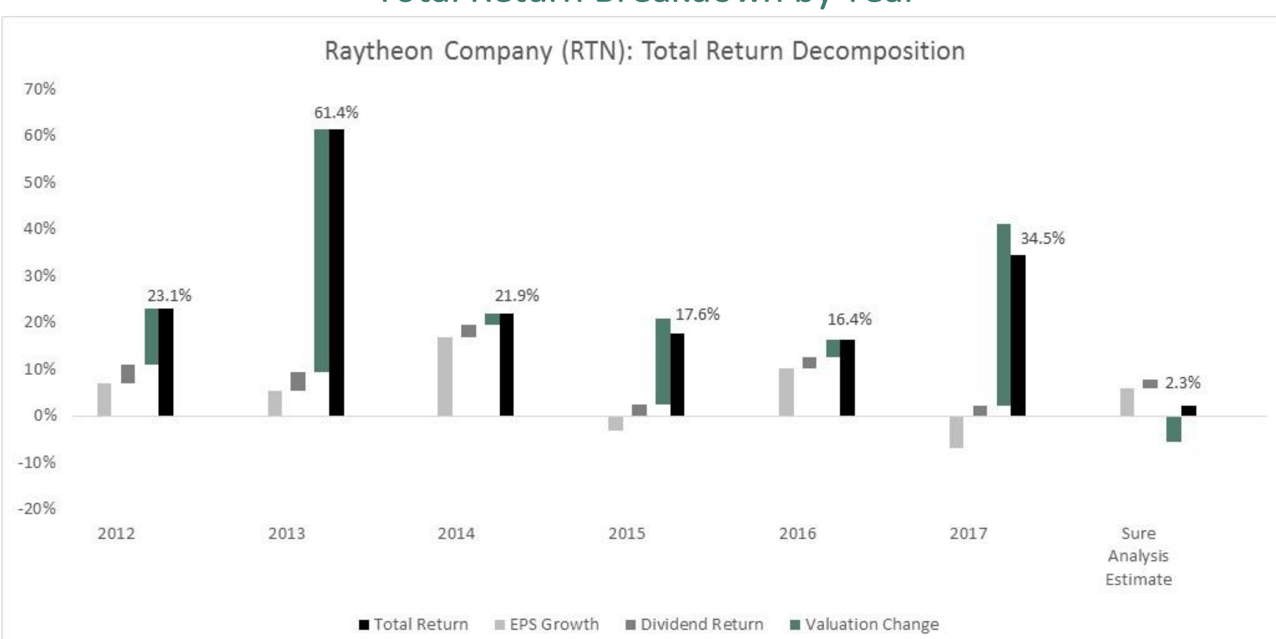
Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	20.3%	21.7%	20%	19.8%	19.9%	19.9%	20%	19.5%	20.4%	20.3%	***20.3%***	***20.3%***
Debt/A	60.3%	57.9%	59.5%	67.7%	69.3%	56.9%	64.9%	64.7%	66.4%	67.7%	***66.9%***	***63.5%***
Int. Cov.	40.8	28	22.5	17.9	15.5	15	15.7	13.8	15.4	18	***18.5***	***20.3***
Payout	28.4%	25.4%	31.3%	32.6%	35.4%	36.9%	34.7%	39.7%	39.4%	46%	***35.1%***	***35.1%***
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, 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

After the recent price decline and earnings results, we now anticipate shares of Raytheon offering total returns of 2.3% per year through 2023, up from an annual decline of 0.6%. This forecast is based off of growth (6%), dividends (1.8%) and multiple contraction (5.5%). Compared to the four other largest defense contractors, Raytheon has the lowest expected total return. While quarterly results were solid, we encourage investors to consider Northrop Grumman (NOC) or Boeing (BA) before purchasing Raytheon. We place a sell recommendation on the stock, but raise our 2023 target price $14 to $198.

Total Return Breakdown by Year



Disclosure: This analyst has no position in the security discussed in this report and no plans to initiate one in the next 72 hours.