Northrop Grumman (NOC)

Updated October 26th, 2018 by Nate Parsh

Key Metrics

Current Price:	$270	**5 Year CAGR Estimate:**	14.0%	**Volatility Percentile:**	15.7%
Fair Value Price:	$302	**5 Year Growth Estimate:**	10.0%	**Momentum Percentile:**	27.7%
% Fair Value:	89%	**5 Year Valuation Multiple Estimate:**	2.3%	**Growth Percentile:**	88.4%
Dividend Yield:	1.7%	**5 Year Price Target**	$487	**Valuation Percentile:**	66.5%
Dividend Risk Score:	B	**Retirement Suitability Score:**	D	**Total Return Percentile:**	77.8%

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 $47 billion and produced almost $26 billion in revenue in 2017.

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 purchase will add to the Northrop Grumman's debt level, long term Orbital ATK will be accretive to earnings. The combined backlog of the two companies totals more than $60 billion.

Northrop Grumman reported 3rd quarter earnings on October 24th. The company earned $6.54 per share, beating estimates by $2.16 and improving almost 78% year over year. Revenue grew 23.1% to $8.09 billion, beating the market's expectations by $90 million.

Orbital ATK was a significant contributor this quarter, adding the majority of sales growth. Excluding the acquisition, Northrop Grumman's sales grew just 1.5%. Sales for the Aerospace Systems division grew 5%. This was due in large part to higher sales for Manned Aircraft. Northrop Grumman expects to deliver 116 F-35 center fuselages this year, a 25% increase. Innovative Systems, where Orbital-ATK is housed, had revenue growth of 16%. This division was awarded a nearly $800 million contract to develop OmegA rocket for the expendable launch vehicle program. The contract runs through 2024. Mission Systems' sales increased 3% due to higher volumes for Sensors and Processing programs for the F-35 and F-16. The Technology division saw revenues decrease 12% as several programs active in the 3rd quarter of 2017 have been completed. Cash flows improved more than 60% year over year. Northrop Grumman increased the midpoint for expected earnings per share for 2018 to $18.88, up from $16.73 previously. The company's effective tax rate is likely to be in the 13% range for 2018, a significant decrease from the prior year.

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	***$18.88***	***$30.41***
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***
Shares	327	306.9	291	253.9	237.1	216.7	198.4	181.3	175.1	174.1	***170***	***165***

Northrop Grumman's earnings declined somewhat during the last recession, but the company quickly rebounded to growth in 2010. We forecast earnings-per-share growth of 10% through 2023.

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 after raising it 10% on January 25th. We expect that dividend growth will at least mirror earnings growth going forward. Northrop Grumman is very shareholder friendly company. Northrop Grumman has reduced the share count by an average rate of 6.3% since 2008, though share repurchase are likely to slow due to the size of the Orbital ATK purchase.

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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	***14.3***	***16***
Avg. Yld.	2.4%	3.5%	3.0%	3.2%	3.4%	2.7%	2.1%	1.9%	1.6%	1.5%	***1.7%***	***1.6%***

Northrop Grumman's share price has declined $25, or 8.5%, since our August 7th update. The stock currently trades with a price-to-earnings ratio of 14.3. We have a 2023 target P/E of 16 for Northrop Grumman. If shares were to reach our target valuation, shareholders would see an added 2.3% in total returns through 2023.

Safety, Quality, Competitive Advantage, & Recession Resiliency

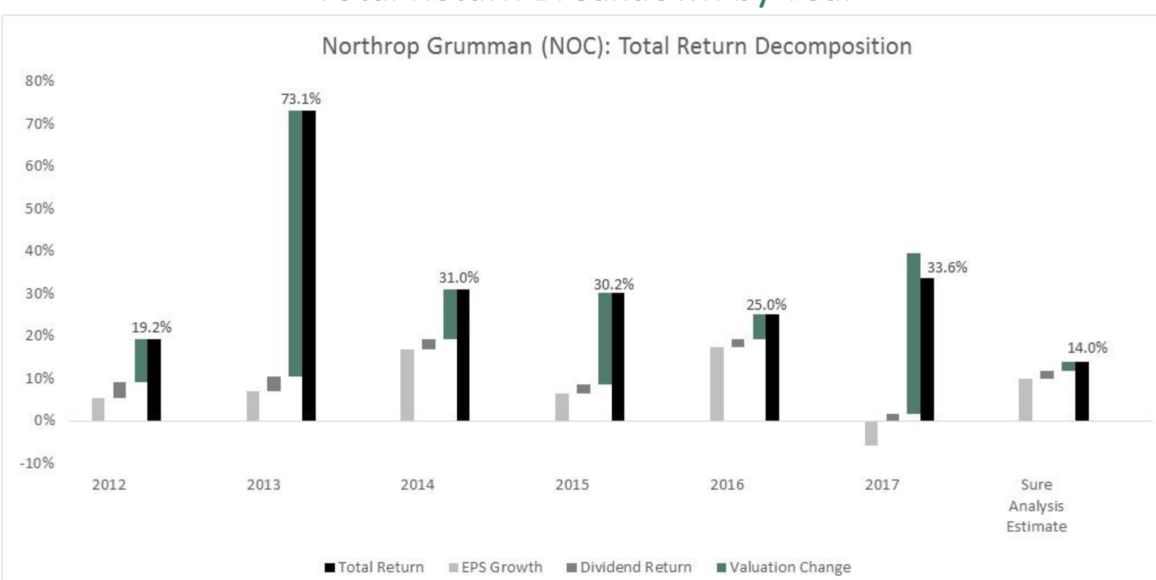
Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	19.7%	18.6%	16.8%	22.1%	21%	20.4%	21.1%	23.1%	22.6%	17.1%	***17.7%***	***20.2%***
Debt/A	60.5%	58.1%	56.9%	59.3%	64.2%	59.7%	72.8%	77.4%	79.5%	79.8%	***82%***	***66.8%***
Int. Cov.	-0.8	9.1	5.3	15	15	12.1	11.4	10.3	10.7	9.5	***9.5***	***9.8***
Payout	29.5%	34.7%	31.7%	26.6%	27.5%	28.5%	27.8%	29.8%	28.7%	34%	***28.1%***	***28.1%***
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 levels are high. 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.

Final Thoughts & Recommendation

We expect that Northrop Grumman can off total returns of 14% annually through 2023, up from 9.7% previously. We arrive at this estimate due to growth estimates (10%), dividends (1.7%) and multiple expansion (2.3%). Northrop Grumman's acquisition of Orbital ATK has already led to substantial revenue growth. The company raised its earnings-per-share guidance for the year and cash flows improved during the quarter. Shares of Northrop Grumman now offer the highest total annual returns in our aerospace and defense coverage universe. The company earns a buy recommendation from Sure Dividend at current prices.

Total Return Breakdown by Year



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

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Income Statement Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Revenue	32315	33755	28143	26412	25218	24661	23979	23526	24508	25803
Gross Profit	5940	5625	5294	5626	5580	5379	5601	5642	5777	5954
Gross Margin	18.4%	16.7%	18.8%	21.3%	22.1%	21.8%	23.4%	24.0%	23.6%	23.1%
SG&A Exp.	3143	3142	2467	2350	2450	2256	2405	2566	2584	2655
D&A Exp.	567	736	555	544	510	495	462	467	456	475
Operating Profit	2797	2483	2827	3276	3130	3123	3196	3076	3193	3299
Op. Margin	8.7%	7.4%	10.0%	12.4%	12.4%	12.7%	13.3%	13.1%	13.0%	12.8%
Net Profit	-1262	1686	2053	2118	1978	1952	2069	1990	2200	2015
Net Margin	-3.9%	5.0%	7.3%	8.0%	7.8%	7.9%	8.6%	8.5%	9.0%	7.8%
Free Cash Flow	2420	1411	1868	1623	2309	2119	2032	1691	1893	1685
Income Tax	859	693	462	997	987	911	868	800	723	1034

Balance Sheet Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Total Assets	30197	30252	31421	25411	26543	26381	26572	24424	25614	34917
Cash & Equivalents	1504	3275	3701	3002	3862	5150	3863	2319	2541	11225
Acc. Receivable	3701	3394	4057	2964	2858	2685	2806	2841	3299	3976
Inventories	1003	1170	1185	873	798	698	742	807	816	780
Goodwill & Int.	14456	14390	14296	12374	12431	12438	12466	12460	12450	12455
Total Liabilities	18277	17565	17864	15075	17029	15761	19337	18902	20355	27869
Accounts Payable	1887	1921	1846	1481	1392	1229	1305	1282	1554	1661
Long-Term Debt	3944	4294	4829	3935	3930	5928	5925	6386	7058	14399
Total Equity	11920	12687	13557	10336	9514	10620	7235	5522	5259	7048
D/E Ratio	0.33	0.34	0.36	0.38	0.41	0.56	0.82	1.16	1.34	2.04

Profitability & Per Share Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Return on Assets	-4.0%	5.6%	6.7%	7.5%	7.6%	7.4%	7.8%	7.8%	8.8%	6.7%
Return on Equity	-8.5%	13.7%	15.6%	17.7%	19.9%	19.4%	23.2%	31.2%	40.8%	32.7%
ROIC	-6.7%	10.3%	11.6%	13.0%	14.3%	13.0%	13.9%	15.9%	18.2%	11.9%
Shares Out.	327	306.9	291	253.9	237.1	216.7	198.4	181.3	175.1	174.1
Revenue/Share	96.61	104.41	93.47	93.79	99.52	105.43	113.06	122.79	135.78	146.94
FCF/Share	7.23	4.36	6.20	5.76	9.11	9.06	9.58	8.83	10.49	9.60

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.