Northrop Grumman (NOC)

Updated January 31st, 2019 by Nathan Parsh

Key Metrics

Current Price:	$276	**5 Year CAGR Estimate:**	13.4%	**Volatility Percentile:**	32.8%
Fair Value Price:	$300	**5 Year Growth Estimate:**	10.0%	**Momentum Percentile:**	22.0%
% Fair Value:	92%	**5 Year Valuation Multiple Estimate:**	1.7%	**Growth Percentile:**	89.8%
Dividend Yield:	1.7%	**5 Year Price Target**	$483	**Valuation Percentile:**	64.6%
Dividend Risk Score:	B	**Retirement Suitability Score:**	C	**Total Return Percentile:**	79.6%

Overview & Current Events

Northrop Aircraft was incorporated in 1939. 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 nearly $49 billion.

On September 18th of 2018, 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 released financial results for the fourth quarter and full year 2018 on January 31st. After adjusting for a pension expense, the company's earnings-per-share (EPS) were $4.93 for the quarter. This beat estimates by $0.51 and improved 75% from the prior year. Revenue increased 24.5% to $8.2 billion, which topped expectations by $36 million. For 2018, adjusted EPS improved 52% to $21.33, which was above Northrop Grumman's guidance. Revenue increased 16% to $30.1 billion. Free cash flow improved 38% to $2.8 billion for the year.

Aerospace Systems posted sales growth of 6% for the quarter and 8% for 2018. Volumes for manned aircraft and space programs were the main driver of growth for this segment. Space sales also benefited from Ground Based Strategic Deterrent TMRR program. Revenues from the Innovative Systems division were higher by 7% for the quarter and 17% for the year. Orbital ATK, which is housed in IS, is expected to add about $2 billion to full year sales in 2019. Defense systems had strong international growth for the Advanced Anti-Radiation Guided Missile program. Mission Systems saw revenues inch up 2% for both the quarter and full year. Technology Services saw an 8% decline in sales for both the fourth quarter and year. This is due to the completion of several programs in 2017. All four divisions participate in the F-35 program either through production or sustainment. This program contributed almost $3 billion to Northrop Grumman's sales during the year. Northrop Grumman expects sales from the F-35 program to grow at by at least a mid-single digit rate in 2019.

Northrop Grumman expects adjusted EPS to range between $18.50 to $19.00 in 2019. Revenue is expected to be ~$34 billion, with free cash flow between $2.6 billion and $3.0 billion. Shares declined almost 2% following the financial results release. This decline was likely due to the company's guidance being below consensus EPS of $19.49 for 2019.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	$4.87	$5.80	$7.41	$7.81	$8.35	$9.75	$10.39	$12.19	$11.47	$21.33	***$18.75***	***$30.20***
DPS	$1.69	$1.84	$1.97	$2.15	$2.38	$2.71	$3.10	$3.50	$3.90	$4.70	***$4.80***	***$7.73***
Shares	306.9	291	253.9	237.1	216.7	198.4	181.3	175.1	174.1	170	***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 2024. As Northrop Grumman has paused its share repurchases as it digests its Orbital ATK purchase, this growth will be achieved mostly by revenue increases. Sales are expected to grow by 13% in 2019.

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 of last year after raising it 10% on January 25th. We expect that dividend growth will at least mirror earnings growth going forward. And, Northrop Grumman has reduced the share count by an *average rate of 6.3% annually* since 2008.

Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	9.9	10.5	8.3	8.2	10.4	12.9	16.1	17.4	23	13	***14.7***	***16***
Avg. Yld.	3.5%	3.0%	3.2%	3.4%	2.7%	2.1%	1.9%	1.6%	1.5%	1.7%	***1.7***	***1.6%***

Northrop Grumman's share price has increased $6, or 2%, since our October 25th update. Using guidance for 2019, the stock currently trades with a price-to-earnings ratio of 14.7. We have a 2024 target P/E of 16 for Northrop Grumman. If shares were to reach our target valuation, shareholders would see an added 1.7% in total returns through 2024.

Safety, Quality, Competitive Advantage, & Recession Resiliency

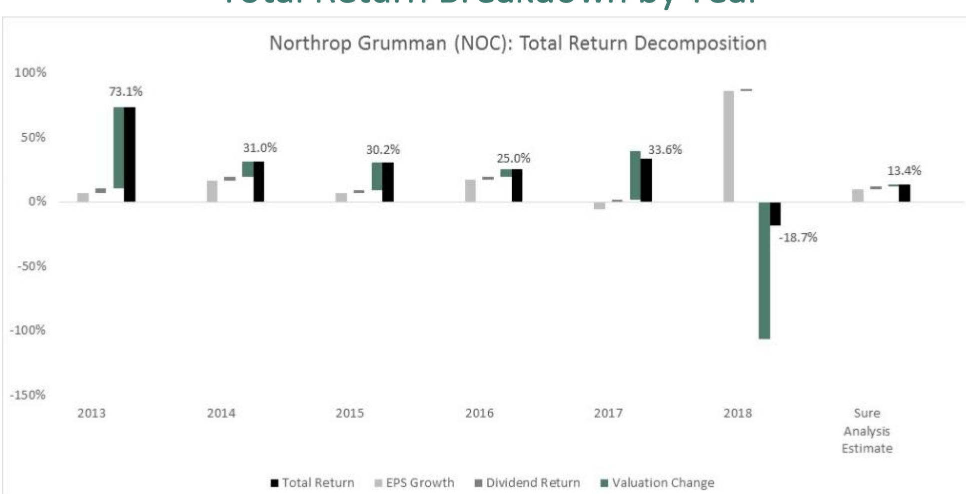
Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	34.7%	31.7%	26.6%	27.5%	28.5%	27.8%	29.8%	28.7%	34%	25%	***22%***	***25.6%***

A key competitive advantage for Northrop Grumman is that its expertise in engineering would be difficult for competitors to duplicate. The company's unmanned and stealth aircraft and sensor programs are in high demand by customers. In most cases, there is just one other company that can produce the products that Northrop Grumman does. The Orbital ATK addition makes Northrop Grumman the largest supplier of ammunition to the U.S. government.

Final Thoughts & Recommendation

While Northrop Grumman showed top and bottom line growth in the fourth quarter and full year, the company's guidance caused the stock to experience a small selloff after the financial report. We feel that investors who are able to see past expected weakness in 2019 could be rewarded by purchasing shares of the company today. We project a total annual return of 13.4% through 2024, down from 14% previously. This is due almost entirely to lower than expected EPS guidance. We have lowered our price target $5 to $483 because of this, but maintain our buy rating on the stock.

Total Return Breakdown by Year



Click here to rate and review this research report. Your feedback is important to us.

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.

Northrop Grumman (NOC)

Updated January 31st, 2019 by Nathan Parsh

Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	33755	28143	26412	25218	24661	23979	23526	24706	26004	30095
Gross Profit	5625	5294	5626	5580	5379	5601	5642	5909	5930	6791
Gross Margin	16.7%	18.8%	21.3%	22.1%	21.8%	23.4%	24.0%	23.9%	22.8%	22.6%
SG&A Exp.	3142	2467	2350	2450	2256	2405	2566	2632	2712	3011
D&A Exp.	736	555	544	510	495	462	467	456	475	800
Operating Profit	2483	2827	3276	3130	3123	3196	3076	3277	3218	3780
Op. Margin	7.4%	10.0%	12.4%	12.4%	12.7%	13.3%	13.1%	13.3%	12.4%	12.6%
Net Profit	1686	2053	2118	1978	1952	2069	1990	2043	2869	3229
Net Margin	5.0%	7.3%	8.0%	7.8%	7.9%	8.6%	8.5%	8.3%	11.0%	10.7%
Free Cash Flow	1411	1868	1623	2309	2119	2032	1691	1893	1685	2578
Income Tax	693	462	997	987	911	868	800	638	1360	513

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	30252	31421	25411	26543	26381	26572	24424	25614	35128	37653
Cash & Equivalents	3275	3701	3002	3862	5150	3863	2319	2541	11225	1579
Acc. Receivable	3394	4057	2964	2858	2685	2806	2841	3299	1054	1448
Inventories	1170	1185	873	798	698	742	807	816	398	654
Goodwill & Int.	14390	14296	12374	12431	12438	12466	12460	12450	12507	20044
Total Liabilities	17565	17864	15075	17029	15761	19337	18902	20355	27996	29466
Accounts Payable	1921	1846	1481	1392	1229	1305	1282	1554	1661	2182
Long-Term Debt	4294	4829	3935	3930	5928	5925	6386	7058	14399	13883
Total Equity	12687	13557	10336	9514	10620	7235	5522	5259	7132	8187
D/E Ratio	0.34	0.36	0.38	0.41	0.56	0.82	1.16	1.34	2.02	1.70

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	5.6%	6.7%	7.5%	7.6%	7.4%	7.8%	7.8%	8.2%	9.4%	8.9%
Return on Equity	13.7%	15.6%	17.7%	19.9%	19.4%	23.2%	31.2%	37.9%	46.3%	42.2%
ROIC	10.3%	11.6%	13.0%	14.3%	13.0%	13.9%	15.9%	16.9%	17.0%	14.8%
Shares Out.	306.9	291	253.9	237.1	216.7	198.4	181.3	175.1	174.1	170
Revenue/Share	104.41	93.47	93.79	99.52	105.43	113.06	122.79	136.88	148.09	172.37
FCF/Share	4.36	6.20	5.76	9.11	9.06	9.58	8.83	10.49	9.60	14.77

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