Raytheon Company (RTN)

Updated May 14th, 2019 by Prakash Kolli

Key Metrics

Current Price:	$178	**5 Year CAGR Estimate:**	7.7%	**Volatility Percentile:**	26.1%
Fair Value Price:	$173	**5 Year Growth Estimate:**	6.0%	**Momentum Percentile:**	23.9%
% Fair Value:	103%	**5 Year Valuation Multiple Estimate:**	-0.4%	**Growth Percentile:**	52.6%
Dividend Yield:	2.1%	**5 Year Price Target**	$231	**Valuation Percentile:**	46.7%
Dividend Risk Score:	B	**Retirement Suitability Score:**	C	**Total Return Percentile:**	39.3%

Overview & Current Events

Raytheon Company is one of the five largest U.S. defense contractors based on revenue. The company had over $27B in sales in 2018. Raytheon operates five business segments that are Integrated Defense Systems (missile defense), Intelligence and Information Systems (services, training, engineering and logistics), Missile Systems (produces munitions and missiles), Space and Airborne Systems (airborne radars and sensors) and a Forcepoint (a cybersecurity business). Approximately 70% of sales are to U.S. Department of Defense with the rest mostly from other U.S. agencies and international military sales. The company's most well-known product is the Patriot system. The company has a market capitalization of ~$49.8B.

Raytheon reported excellent Q1 2019 earnings on April 25, 2019. Companywide, net sales increased 7.4% to $6.7B and earnings per share increased 25.9% to $2.77B on a year-over-year basis. Companywide operating margins decreased (10 bps) to 16.6%. Integrated Defense Systems had Q1 2019 net sales of $1,550M, up 4% compared to $1,489M in Q1 2018. This increase was primarily driven by higher volume on various Patriot programs and a naval radar program. Net sales increased 12% to $1,777M for Intelligence and Information Systems on a comparable quarter basis. Growth occurred in classified cyber and space markets. Missile Systems net sales increased 9% to $2,006M in Q1 2019 compared to $1,848M in Q1 2018 due to broad growth across the segment. On a comparable quarter basis, net sales increased 5% to $1,653M in Space and Airborne Systems due to growth in classified programs. Net sales for Forcepoint increased 12% to $158M. But notably this segment had an operating loss and negative operating margins of (5.7%). Raytheon grew bookings by $5,368M. The backlog grew 8% to $41.1B.

Raytheon expects EPS between $11.40 - $11.60 and revenue to range from $28.6B to $29.1B for 2019. Achieving the midpoint of the company's guidance would result in growth of 13.3% for EPS and 6.5% for revenue. Operating cash flow is expected to be ~$4B for the current year.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	$4.89	$4.79	$5.28	$5.65	$5.96	$6.97	$6.75	$7.44	$6.94	$10.15	***$11.50***	***$15.39***
DPS	$1.24	$1.50	$1.72	$2.00	$2.20	$2.42	$2.68	$2.93	$3.19	$3.40	***$3.47***	***$5.54***
Shares	383.2	359	339	328	314.5	307.3	299	293	288	280	***276***	***250***

Raytheon's earnings per share have exhibited some volatility over the past 10 years. Saying that, there has been a consistent long-term trend upward. In fact, EPS has increased significantly since 2017 due to higher revenues, improved operating margins and lower share count. We expect these trends to continue in the near future. Top line growth should come from higher defense spending in the U.S. combined with growing international sales, especially of the Patriot system. Note that Forcepoint is currently providing headwinds for EPS growth and we do not expect that to change in the near future. But in all, we are forecasting an average increase of 6% annually in EPS.

Raytheon dividend per share was growing at a double-digit rate until about 2016. The growth rate has slowed since then and we are now expecting an 8% growth in DPS. Note that the payout ratio is relatively low at only ~32.8%. Hence, there is room for further increases even if defense spending slows down due to budget battles.

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Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	9.4	10.6	8.9	9.5	11.7	14.0	16.2	18.0	24.2	17.6	***15.3***	***15***
Avg. Yld.	2.7%	3.0%	3.7%	3.7%	3.2%	2.5%	2.5%	2.2%	1.9%	2.0%	***2.1%***	***2.5%***

Our current fair value is $173 based on a long-term price-to-earnings multiple of 15.0 and expected 2019 earnings of $11.50 per share. We assign a P/E multiple slightly greater than the 10-year average due to higher expected defense spending and good operational performance. The EPS is the mid-point of Raytheon's forecast for 2019. Based on the closing price on May 14th of $178, the stock is slightly overvalued. We expect the dividend yield to increase to 2.5%, which is slightly lower than the 10-year average. Our 5-year price target is $231.

Safety, Quality, Competitive Advantage, & Recession Resiliency

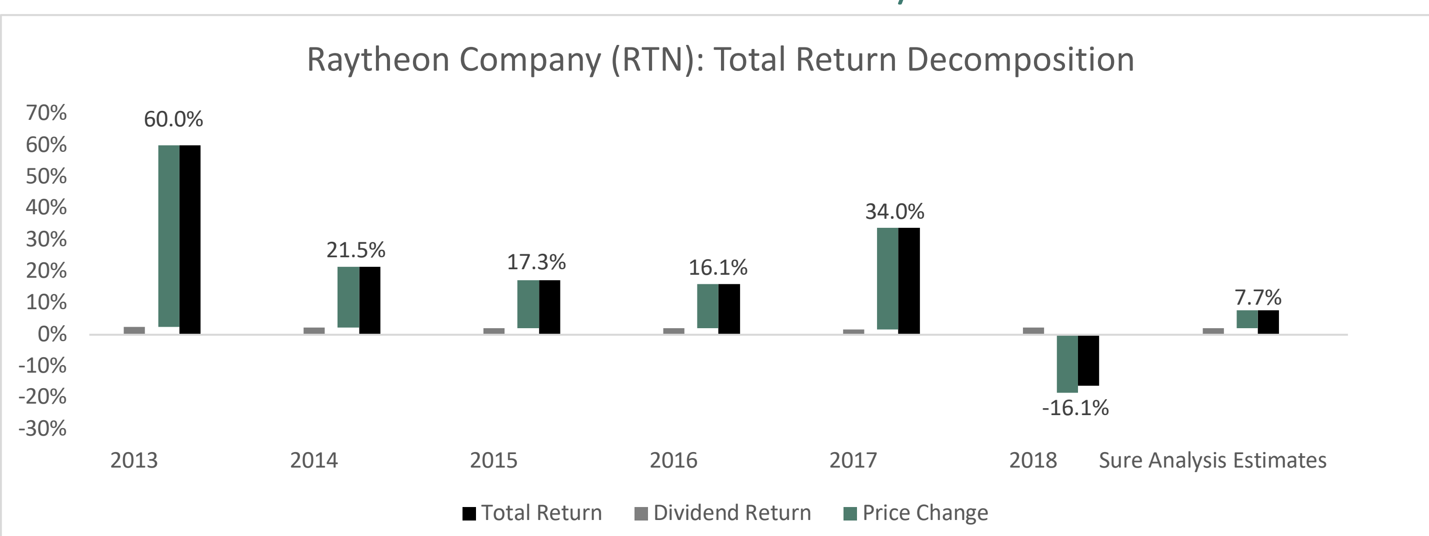
Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	25.4%	31.3%	32.6%	35.4%	36.9%	34.7%	39.7%	39.4%	46%	33.5%	***32.8%***	***36.0%***

As a U.S. defense contractor, Raytheon has an entrenched position in many of its end markets. Of note is the Patriot system, which has large installed base in the U.S. and in allied militaries around the world. This system typically requires technology upgrades and also service and maintenance contracts. Raytheon also has significant strengths in naval ship systems, has a duopoly with Lockheed Martin in missile production and has a major presence in space and airborne radars. This gives Raytheon a competitive advantage in that they are often the only one of two companies that can provided needed technologies to U.S. DoD. These characteristics lead to a good degree of recession resistance. However, the company does face risks in program cuts during U.S. budget battles that could lead to revenue declines.

Final Thoughts & Recommendation

At present we are forecasting a 7.7% total annual return through 2024 down from our last report due to stock price gains. The return is comprised of 6.0% earnings growth, 2.1% dividend yield and -0.4% from multiple contraction. Raytheon's businesses are performing well with the exception of the Forcepoint segment and the current stock price reflects this performance. We currently rate this stock a hold.

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	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	24881	25150	24791	24414	23706	22826	23321	24124	25348	27058
Gross Profit	5134	4877	5127	5322	5174	5531	5713	6159	6272	7485
Gross Margin	20.6%	19.4%	20.7%	21.8%	21.8%	24.2%	24.5%	25.5%	24.7%	27.7%
SG&A Exp.	1527	1639	1847	1882	1771	1852	1940	2109	2220	2106
D&A Exp.	402	414	444	455	445	439	489	515	550	568
Operating Profit	3042	2613	2830	2989	2938	3179	3067	3295	3318	4538
Op. Margin	12.2%	10.4%	11.4%	12.2%	12.4%	13.9%	13.2%	13.7%	13.1%	16.8%
Net Profit	1935	1840	1866	1888	1996	2244	2110	2244	2024	2909
Net Margin	7.8%	7.3%	7.5%	7.7%	8.4%	9.8%	9.0%	9.3%	8.0%	10.8%
Free Cash Flow	2378	1556	1670	1542	2049	1804	1902	2227	2134	2607
Income Tax	953	590	782	878	808	790	747	873	1114	264

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	23607	24422	25854	26686	25967	27716	29281	30238	30860	31864
Cash & Equivalents	2642	3638	4000	3188	3296	3222	2328	3303	3103	3608
Acc. Receivable	4493	4414	1183	1131	1223	1042	1174	1163	1324	1648
Inventories	344	363	336	381	363	414	635	608	594	758
Goodwill & Int.	11922	12045	13192	13420	13339	13677	15725	15677	15640	14864
Total Liabilities	13668	14532	17514	18496	14770	17995	18951	20081	20897	20392
Accounts Payable	1397	1538	1507	1348	1178	1250	1402	1520	1519	1964
Long-Term Debt	2329	3610	4605	4731	4734	5325	5330	5335	5050	5055
Total Equity	9827	9754	8181	8026	11035	9525	10128	10157	9963	11472
D/E Ratio	0.24	0.37	0.56	0.59	0.43	0.56	0.53	0.53	0.51	0.44

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	8.3%	7.7%	7.4%	7.2%	7.6%	8.4%	7.4%	7.5%	6.6%	9.3%
Return on Equity	20.5%	18.8%	20.8%	23.3%	20.9%	21.8%	21.5%	22.1%	20.1%	27.1%
ROIC	16.3%	14.3%	14.1%	14.6%	13.8%	14.5%	13.7%	14.4%	13.3%	18.4%
Shares Out.	383.2	359	339	328	314.5	307.3	299	293	288	280
Revenue/Share	62.88	66.71	70.11	73.05	73.12	73.02	76.41	81.28	86.99	94.34
FCF/Share	6.01	4.13	4.72	4.61	6.32	5.77	6.23	7.50	7.32	9.09

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