Northrop Grumman (NOC)

Updated July 29th, 2019 by Prakash Kolli

Key Metrics

Current Price:	$355	**5 Year CAGR Estimate:**	7.6%	**Volatility Percentile:**	40.3%
Fair Value Price:	$291	**5 Year Growth Estimate:**	10.0%	**Momentum Percentile:**	76.3%
% Fair Value:	122%	**5 Year Valuation Multiple Estimate:**	-3.9%	**Growth Percentile:**	90.4%
Dividend Yield:	1.5%	**5 Year Price Target**	$469	**Valuation Percentile:**	29.6%
Dividend Risk Score:	A	**Retirement Suitability Score:**	C	**Total Return Percentile:**	45.8%

Overview & Current Events

Northrop Grumman Corp. is one of the five largest U.S. aerospace and defense contractors based on revenue. The company reports four business segments: Aerospace Systems (aircraft and space systems), Mission Systems (radars, sensors and systems for surveillance and targeting), Technology Services (cybersecurity, information technology, logistics and maintenance), and Innovation Systems (missile defense, space systems, hypersonics and space launchers). Northrop Grumman completed its acquisition of Orbital ATK in June 2018 and stood up a new business segment, Innovation Systems. Northrop Grumman makes the well-known B-2 Spirit stealth bomber, E-2D Advanced Hawkeye and E-8C JSTARS. The company also provides content on the F-35 Lightening II and F/A-18 Super Hornet. It also won the contract for the B-21 Raider. In addition, the company makes the RQ-4 Global Hawk, MQ-4C Triton and MQ-8B/C Fire Scout UAVs. The company had revenue of over $30B in 2018. The current market capitalization is ~$60B.

Northrop Grumman released another solid earnings report for Q2 2019 on July 24, 2019. The company beat revenue and GAAP EPS estimates. Revenue increased 19% to $8,456M from $7,119M on a year-over-year basis due to organic growth and acquisitions. Diluted EPS increased 12% to $5.06 from $4.50 in comparable periods. Both the Aerospace Systems and Mission Systems segments increased revenue and operating income. Revenue for the Aerospace System increased 2% to $3,390M from $3,337M from the prior year due to higher volumes in F-35 production activity and civilian space programs. Revenue for the Innovation Systems increased 8% to $1,498M from pro forma sales of $1,400M in comparable quarters on the strength of higher sales in military aerospace structures and launch vehicles, and tactical missiles and subsystems. Revenue for Mission Systems increased 9% to $3,218M in the quarter from $2,874M in the prior year due higher volumes in Sensors and Processing, Advanced Capabilities, and Cyber and ISR. On the other hand, Technology Services had flattish sales of $1,044M in Q2 2019 from $1,048M in Q2 2018.

Notably, companywide backlog increased 10% to $63B. Northrop Grumman received $13.5B in awards in Q2 2019 including $4.1B for the F-35 program, $3.6B for 24 E-2D Advance Hawkeye aircraft, and smaller amounts for other programs. On the strength of the quarter's results Northrop Grumman increased expected adjusted EPS to range from $19.30 to $19.55 for 2019. Revenue is expected to be ~$34B.

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	***$19.43***	***$31.29***
DPS	$1.69	$1.84	$1.97	$2.15	$2.38	$2.71	$3.10	$3.50	$3.90	$4.70	***$5.16***	***$7.58***
Shares	306.9	291	253.9	237.1	216.7	198.4	181.3	175.1	174.1	170.7	***167***	***151***

Northrop Grumman's earnings can be volatile based on budget and program cycles. But saying that, the bottom line has increased substantially over time driven by top line growth from contract wins, modernization and upgrades, and services. A significant reduction in share count has helped drive EPS gains as well. Looking forward, the company will achieve both revenue and EPS growth through its involvement in the F-35, B-21, E2-D and other platforms. We expect average annual EPS growth of 10.0% out to 2024. We expect share buybacks to slow as the company pays down debt after the Orbital ATK acquisition. Northrop Grumman has paid a growing dividend for 16 years. The payout ratio is currently low at ~27.0% so there is room for further increases, but share repurchases may take priority here.

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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	23.0	16.8	***18.3***	***15.0***
Avg. Yld.	3.5%	3.0%	3.2%	3.4%	2.7%	2.1%	1.9%	1.6%	1.5%	1.7%	***1.5%***	***2.4%***

We have raised our current fair value slightly to $291 based on expected 2019 earnings and P/E ratio of 15.0. We use a P/E multiple greater than the long-term average of ~13.4 to account for synergies from the Orbital ATK acquisition and growth from the F-35, B-21 and E-2D programs. Our 5-year price target is $469.

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%	34.0%	25.4%	***26.6%***	***24.2%***

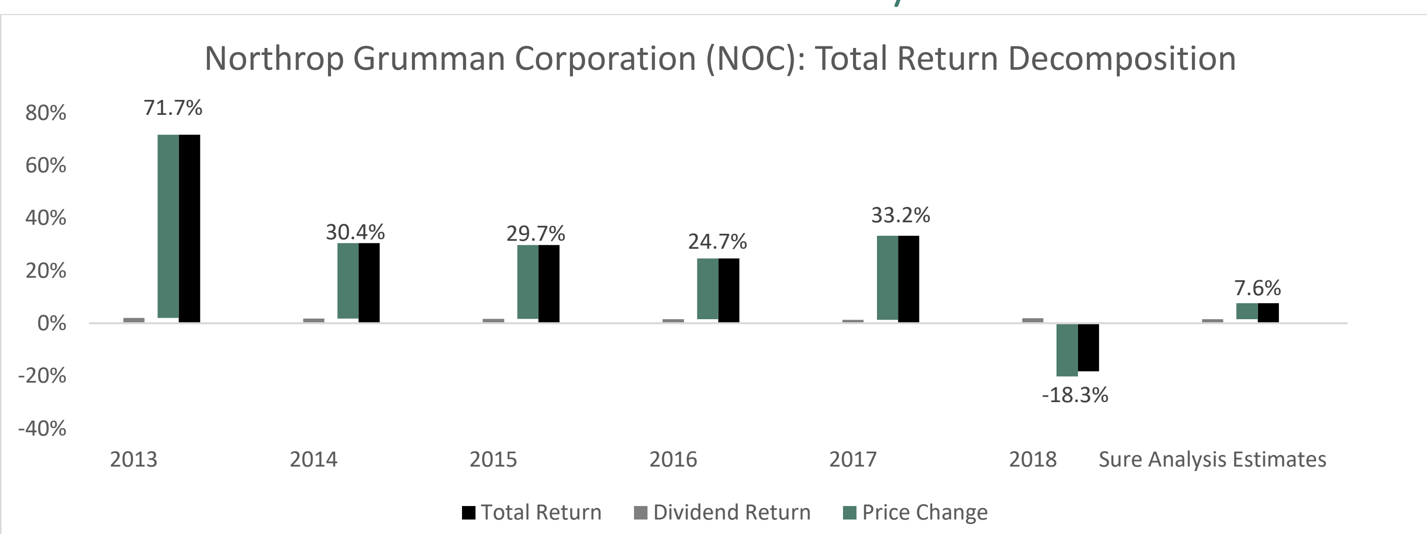
As a U.S. prime defense contractor, Northrop Grumman has an entrenched position in many of its end markets. Of note are the B-2, B-21, E-2D, E-8C, Global Hawk and Triton platforms. These platforms have decades long life cycles and Northrop Grumman has the expertise and experience to perform sustainment and modernization. The Orbital ATK addition makes Northrop Grumman the largest supplier of ammunition to the U.S. government. 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. Another risk is that Northrop Grumman has exposure to Information Technology and cybersecurity. These are competitive fields. Furthermore, traditional IT companies are moving into government contracting focusing on DoD and cybersecurity. These companies often have broader and deeper experience and expertise in IT compared to Northrop Grumman.

Debt has increased due to the acquisition. Long-term debt is now at $13,838M offset by $1,088 in cash and equivalents.

Final Thoughts & Recommendation

At present we are forecasting a 7.6% total annual return through 2024 down from our last report due to stock price gains. The return is comprised of 10.0% earnings growth, 1.5% dividend yield and -3.9% from multiple contraction. Northrop Grumman's businesses are generally performing well and growing. However, the current stock price currently reflects performance and optimism, and the dividend yield is relatively low. Hence, we currently rate this stock as 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	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.