Northrop Grumman Corporation (NOC)

Updated February 10th, 2019 by Prakash Kolli

Key Metrics

Current Price:	$361	**5 Year CAGR Estimate:**	10.5%	**Market Cap:**	$60,844M
Fair Value Price:	$347	**5 Year Growth Estimate:**	10.0 %	**Ex-Dividend Date:**	11/29/19
% Fair Value:	104%	**5 Year Valuation Multiple Estimate:**	-0.8%	**Dividend Payment Date:**	12/18/19
Dividend Yield:	1.5%	**5 Year Price Target**	$559	**Years Of Dividend Growth:**	16
Dividend Risk Score:	A	**Retirement Suitability Score:**	C	**Last Dividend Increase:**	9.8%

Overview & Current Events

Northrop Grumman Corporation 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 $33.8B in 2019.

Northrop Grumman released mixed results for Q4 2019 on January 30, 2020. Companywide revenue increased 7% to $8,721M from $8,156M and diluted adjusted earnings per share increased to $5.61 from $4.93 on a year-over-year basis. Three of the four business segments had increases in sales, with Technology Services reporting a decrease. Revenue for Aerospace System increased 10% to $3,518M from $3,197M from the prior year due to higher volumes in the E-2 and F-35 aircraft, and space. Revenue for Innovation Systems increased 9% to $1,599M from $1,461M in comparable quarters on the strength of higher sales in satellite systems, propulsion systems, and tactical missiles. Revenue for Mission Systems increased 6% to $3,220M in the quarter from $3,041M in the prior year due higher volumes in marine systems, space and restricted programs, and airborne radar programs. Revenue for Technology Services declined (4%) to $1,022M in Q4 2019 from $1,065M in Q4 2018 due to completion of state and local programs and lower volumes in manned aircraft programs offset by higher sales in autonomous platforms.

For the year, revenue increased 12% to $33.8B from $30.1B and diluted adjusted earnings per share was flat at $21.21 compared to $21.33 in the prior. Companywide backlog increased 21% to $64.8B versus $53.5B at end of 2018. The company's book-to-bill ratio remains healthy at 1.3.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	$5.80	$7.41	$7.81	$8.35	$9.75	$10.39	$12.19	$11.47	$21.33	$21.21	***$23.15***	***$37.28***
DPS	$1.84	$1.97	$2.15	$2.38	$2.71	$3.10	$3.50	$3.90	$4.70	$5.16	***$5.57***	***$8.18***
Shares[1]	291	253.9	237.1	216.7	198.4	181.3	175.1	174.1	170.7	167	***164***	***148***

Northrop Grumman's earnings 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 earnings per share 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% out to 2025. 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 ~24% so there is room for further increases.

[1] Share count in millions.

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Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	10.5	8.3	8.2	10.4	12.9	16.1	17.4	23.0	16.8	***17.9***	***15.6***	***15.0***
Avg. Yld.	3.0%	3.2%	3.4%	2.7%	2.1%	1.9%	1.6%	1.5%	1.7%	***1.7%***	***1.5%***	***1.5%***

Northrop Grumman's stock price continues to rise due to higher earnings per share and major contract wins. Earnings per share for 2019 came in better than forecast. Our current fair value is $347 based on consensus 2020 EPS and a multiple of 15.0. We use a P/E multiple greater than the trailing 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 raised to $559.

Safety, Quality, Competitive Advantage, & Recession Resiliency

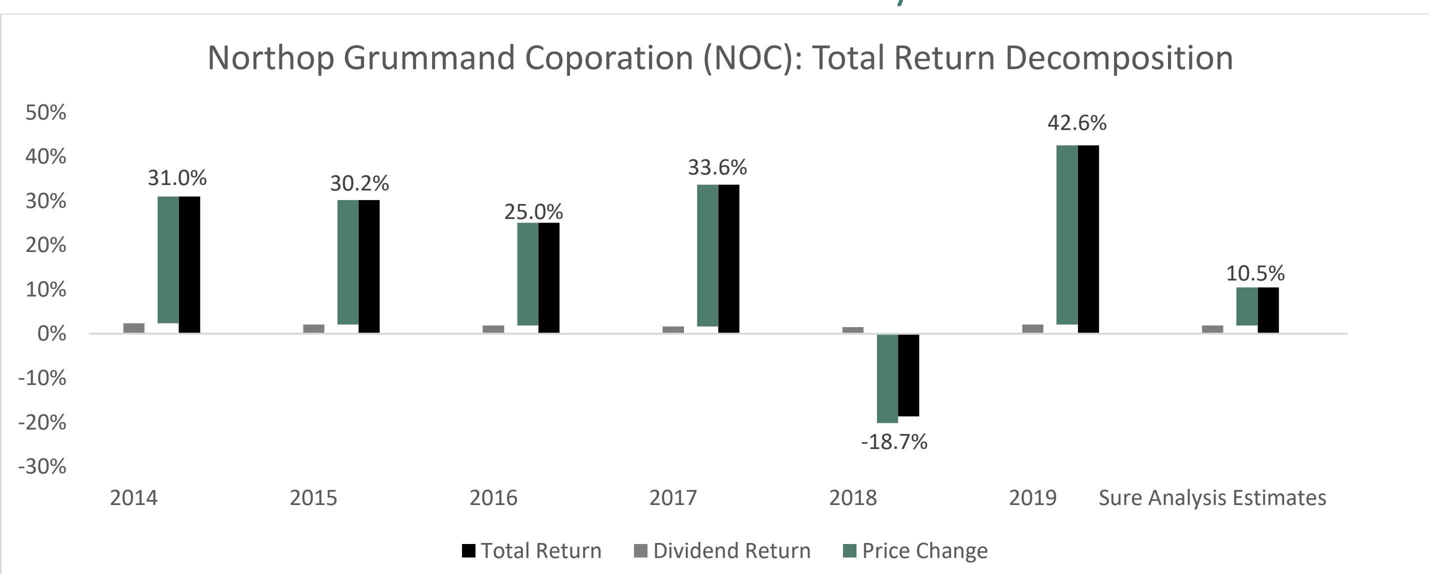
Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2024
Payout	32%	27%	28%	29%	28%	30%	29%	34%	25%	24%	***24%***	***22%***

As a prime U.S. 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. These characteristics lead to a good degree of recession resistance. However, the company does face risks in program cuts that could lead to revenue declines. Another risk is that Northrop Grumman has exposure to Information Technology and cybersecurity. These are competitive fields. Traditional IT companies are moving into government contracting focusing on DoD and cybersecurity. These companies often have broader and deeper expertise in IT compared to Northrop Grumman. Debt has increased due to the acquisition. Long-term debt is now at $12,770M offset by $2,245M in cash and equivalents.

Final Thoughts & Recommendation

At present we are forecasting an 10.5% average total annual return through 2025 up from our last report. Northrop Grumman's four businesses are performing well and positioned in growth areas. The company continues to win large contracts and U.S. defense spending is robust. However, the current stock price reflects near-term optimism, and the dividend yield is relatively low. Investors may want to wait for a better entry point. We 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	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	28143	26412	25218	24661	23979	23526	24706	26004	30095	33841
Gross Profit	5294	5626	5580	5379	5601	5642	5909	5930	6791	7259
Gross Margin	18.8%	21.3%	22.1%	21.8%	23.4%	24.0%	23.9%	22.8%	22.6%	21.5%
SG&A Exp.	2467	2350	2450	2256	2405	2566	2632	2712	3011	3290
D&A Exp.	555	544	510	495	462	467	456	475	800	1018
Operating Profit	2827	3276	3130	3123	3196	3076	3277	3218	3780	3969
Op. Margin	10.0%	12.4%	12.4%	12.7%	13.3%	13.1%	13.3%	12.4%	12.6%	18.8%
Net Profit	2053	2118	1978	1952	2069	1990	2043	2869	3229	2248
Net Margin	7.3%	8.0%	7.8%	7.9%	8.6%	8.5%	8.3%	11.0%	10.7%	10.7%
Free Cash Flow	1868	1623	2309	2119	2032	1691	1893	1685	2578	3033
Income Tax	462	997	987	911	868	800	638	1360	513	300

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	31421	25411	26543	26381	26572	24424	25614	35128	37653	41089
Cash & Equivalents	3701	3002	3862	5150	3863	2319	2541	11225	1579	2245
Acc. Receivable	4057	2964	2858	2685	2806	2841	3299	1054	1448	1326
Inventories	1185	873	798	698	742	807	816	398	654	783
Goodwill & Int.	14296	12374	12431	12438	12466	12460	12450	12507	20044	19748
Total Liabilities	17864	15075	17029	15761	19337	18902	20355	27996	29466	32270
Accounts Payable	1846	1481	1392	1229	1305	1282	1554	1661	2182	2226
Long-Term Debt	4829	3935	3930	5928	5925	6386	7058	14399	13883	12770
Total Equity	13557	10336	9514	10620	7235	5522	5259	7132	8187	8819
D/E Ratio	0.36	0.38	0.41	0.56	0.82	1.16	1.34	2.02	1.70	1.45

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	6.7%	7.5%	7.6%	7.4%	7.8%	7.8%	8.2%	9.4%	8.9%	5.7%
Return on Equity	15.6%	17.7%	19.9%	19.4%	23.2%	31.2%	37.9%	46.3%	42.2%	26.4%
ROIC	11.6%	13.0%	14.3%	13.0%	13.9%	15.9%	16.9%	17.0%	14.8%	10.3%
Shares Out.	291	253.9	237.1	216.7	198.4	181.3	175.1	174.1	170	167
Revenue/Share	93.47	93.79	99.52	105.43	113.06	122.79	136.88	148.09	172.37	199.06
FCF/Share	6.20	5.76	9.11	9.06	9.58	8.83	10.49	9.60	14.77	17.84

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