Raytheon Company (RTN)

Updated February 10th, 2020 by Prakash Kolli

Key Metrics

Current Price:	$228	**5 Year CAGR Estimate:**	6.0%	**Market Cap:**	$63,482M
Fair Value Price:	$191	**5 Year Growth Estimate:**	8.0%	**Ex-Dividend Date:**	01/07/20
% Fair Value:	119%	**5 Year Valuation Multiple Estimate:**	-3.4%	**Dividend Payment Date:**	01/30/20
Dividend Yield:	1.7%	**5 Year Price Target**	$281	**Years Of Dividend Growth:**	15
Dividend Risk Score:	B	**Retirement Suitability Score:**	C	**Last Dividend Increase:**	6.5%

Overview & Current Events

Raytheon Company is one of the five largest U.S. defense contractors based on revenue. 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 Forcepoint (a cybersecurity business). Approximately 70% of sales are to the U.S. Department of Defense with the rest mostly from other U.S. agencies and international military sales. The company's best-known products are the Patriot missile defense system and the Tomahawk cruise missile.

Raytheon reported another excellent quarter for Q4 2019 on January 30th, 2020. Companywide net sales increased 6.5% to $7,842M from $7,360M and diluted EPS from continuing operations increased 7.8% to $3.16 from $2.93 on year-over-year basis. The company had $12,058M in bookings and the backlog grew to a record $48,752M. All five business segments showed growth. Integrated Defense Systems net sales increased 18% to $1,981M from $1,684M in comparable periods due to higher international sales. Revenue for the Intelligence, Information and Services segment increased 6% to $1,742M from $1,711M in the prior year driven by higher sales in classified cyber and space programs. Revenue for Missile Systems increased 1% to $2,345M from $2,317M in Q4 2018 due to higher sales in classified programs and other programs. Revenue for Space and Airborne Systems increased 10% to $2,018M from $1,880M in comparable periods from strength in classified programs and the Next Generation Overhead Persistent Infrared program. Forcepoint revenue grew 3% to $177M from $172M in the prior year.

For the year, Raytheon's sales increased 16% to $36,340M from $32,162M in 2018 and diluted earnings per share increased 17.4% to $11.92 from $10.15 in 2018.

The Raytheon and United Technologies merger is on track to close in the second quarter of 2020. Raytheon shareholders will own 43% and United Technologies shareholders will own 57% of the merged company. Raytheon shareholders will receive 2.3348 shares in the new company for each share of Raytheon that they own. The merger would create a new company called Raytheon Technologies making it the largest defense contractor. The merger was approved by both boards and also by shareholders. There is risk that the merger may not be completed as United Technologies must spin off the Carrier and Otis divisions and the deal must still pass regulatory and U.S. DoD approvals.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	$4.79	$5.28	$5.65	$5.96	$6.97	$6.75	$7.44	$6.94	$10.15	$11.92	***$12.75***	***$18.73***
DPS	$1.50	$1.72	$2.00	$2.20	$2.42	$2.68	$2.93	$3.19	$3.40	$3.70	***$3.77***	***$5.54***
Shares[1]	359	339	328	314.5	307.3	299	293	288	280	276	***271***	***245***

Raytheon finished 2019 on a strong note due to the continued strength and resilience of the Patriot missile system and robust defense spending. U.S. and international military spending are now strong, and Raytheon is a prime beneficiary with its focus on missiles and radars. We expect higher defense budgets to drive both the top and bottom lines. We are now forecasting an average increase of 8% annually in EPS. Raytheon's dividend per share was growing at a double-digit

[1] Share count in millions.

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.

rate but has slowed, and we are now expecting an 8% average annual growth in the dividend per share. Note that the payout ratio is relatively low at only ~30%. Hence, there is room for further increases even if defense spending slows.

Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	10.6	8.9	9.5	11.7	14.0	16.2	18.0	24.2	19.5	***19.1***	***17.9***	***15.0***
Avg. Yld.	3.0%	3.7%	3.7%	3.2%	2.5%	2.5%	2.2%	1.9%	1.8%	***2.0%***	***1.7%***	***2.0%***

The stock price continues to rise and is now trading above our fair value of $191 even after raising our 2019 EPS estimate. But Raytheon is no longer trading on fundamentals but rather on the expected merger with United Technologies. Our long-range price-to-earnings ratio multiple is 15.0. Our 5-year price target is now $281.

Safety, Quality, Competitive Advantage, & Recession Resiliency

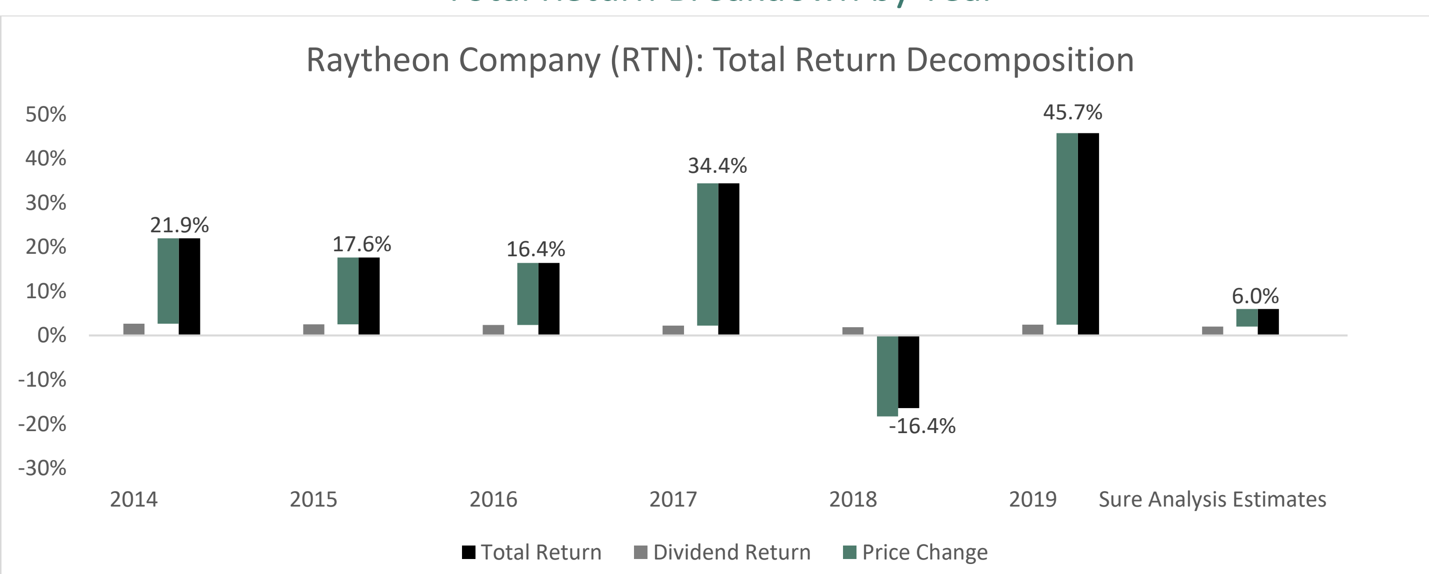
Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	31%	33%	35%	37%	35%	40%	39%	46%	34%	***31%***	***30%***	***30%***

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 a 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 missile 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 only one of two companies that can provide 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 that could lead to revenue declines. Raytheon's balance sheet is very conservative with $1,499M in short-term debt, $3,261M in long-term debt and $4,292M in cash and equivalents.

Final Thoughts & Recommendation

At present we are forecasting a 6.0% annualized total return through 2025 up from our last report. Raytheon's businesses are firing on all cylinders, and investors are seemingly bullish on the impending merger with United Technologies. But the stock is trading above our fair value estimate. At the current share price, we rate this stock a hold.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	25150	24791	24414	23706	22826	23321	24124	25348	27058	29176
Gross Profit	4877	5127	5322	5174	5531	5713	6159	6272	7485	7763
Gross Margin	19.4%	20.7%	21.8%	21.8%	24.2%	24.5%	25.5%	24.7%	27.7%	26.6%
SG&A Exp.	1639	1847	1882	1771	1852	1940	2109	2220	2106	2257
D&A Exp.	414	444	455	445	439	489	515	550	568	605
Operating Profit	2613	2830	2989	2938	3179	3067	3295	3318	4538	4774
Op. Margin	10.4%	11.4%	12.2%	12.4%	13.9%	13.2%	13.7%	13.1%	16.8%	16.4%
Net Profit	1840	1866	1888	1996	2244	2110	2244	2024	2909	3343
Net Margin	7.3%	7.5%	7.7%	8.4%	9.8%	9.0%	9.3%	8.0%	10.8%	11.5%
Free Cash Flow	1556	1670	1542	2049	1804	1902	2227	2134	2607	3473
Income Tax	590	782	878	808	790	747	873	1114	264	658

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	24422	25854	26686	25967	27716	29281	30238	30860	31864	34566
Cash & Equivalents	3638	4000	3188	3296	3222	2328	3303	3103	3608	4292
Acc. Receivable	4414	1183	1131	1223	1042	1174	1163	1324	1648	1364
Inventories	363	336	381	363	414	635	608	594	758	671
Goodwill & Int.	12045	13192	13420	13339	13677	15725	15677	15640	14864	15417
Total Liabilities	14532	17514	18496	14770	17995	18951	20081	20897	20392	22343
Accounts Payable	1538	1507	1348	1178	1250	1402	1520	1519	1964	1796
Long-Term Debt	3610	4605	4731	4734	5325	5330	5335	5050	5055	4760
Total Equity	9754	8181	8026	11035	9525	10128	10157	9963	11472	12223
D/E Ratio	0.37	0.56	0.59	0.43	0.56	0.53	0.53	0.51	0.44	0.39

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	7.7%	7.4%	7.2%	7.6%	8.4%	7.4%	7.5%	6.6%	9.3%	9.9%
Return on Equity	18.8%	20.8%	23.3%	20.9%	21.8%	21.5%	22.1%	20.1%	27.1%	28.2%
ROIC	14.3%	14.1%	14.6%	13.8%	14.5%	13.7%	14.4%	13.3%	18.4%	20.0%
Shares Out.	359	339	328	314.5	307.3	299	293	288	280	276
Revenue/Share	66.71	70.11	73.05	73.12	73.02	76.41	81.28	86.99	94.34	104.13
FCF/Share	4.13	4.72	4.61	6.32	5.77	6.23	7.50	7.32	9.09	12.39

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