Northrop Grumman Corporation (NOC)

Updated January 28th, 2021 by Prakash Kolli

Key Metrics

Current Price:	$292	**5 Year CAGR Estimate:**	13.6%	**Market Cap:**	$48.87B
Fair Value Price:	$351	**5 Year Growth Estimate:**	8.0%	**Ex-Dividend Date:**	11/2720
% Fair Value:	83%	**5 Year Valuation Multiple Estimate:**	3.7%	**Dividend Payment Date:**	12/16/20
Dividend Yield:	2.0%	**5 Year Price Target**	$516	**Years Of Dividend Growth:**	17
Dividend Risk Score:	A	**Retirement Suitability Score:**	B	**Last Dividend Increase:**	9.9%

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: Aeronautics Systems (aircraft and UAVs), Mission Systems (radars, sensors and systems for surveillance and targeting), Defense Systems (information technology, sustainment and modernization, directed energy, tactical weapons), and Space Systems (missile defense, space systems, hypersonics and space launchers). Northrop Grumman completed its acquisition of Orbital ATK in June 2018. Northrop Grumman makes the B-2 Spirit, E-2D, E-8C, RQ-4 Global Hawk, MQ-4C Triton, and MQ-8B/C Fire Scout. The company also provides content on the F-35 and F/A-18. It also won the contract for the B-21. The company had revenue of over $36.8B in 2020.

Northrop Grumman released excellent results for Q4 FY 2020 and FY 2021 on January 28, 2021. For the quarter, companywide revenue increased 17% to $10,212M from $8,721M and diluted adjusted earnings per share increased 16% to $6.59 from $5.61 on a year-over-year basis. For the year, companywide revenue increased 9% to $36,799M from $33,841M and diluted adjusted earnings per share increased to $23.65 from $21.21.

Revenue for Aeronautics Systems increased 24% to $3,487M from $2,807M in the prior year due to higher volumes in restricted programs, E-2D, and Manned Aircraft. Revenue for Defense Systems rose 2% to $1,917M from $1,880M in comparable quarters due to higher sales in Mission Readiness and flat sales in Battle Management & Missile Systems. Revenue for Mission Systems increased 10% to $2,736M in the quarter from $2,486M in the prior year due higher volumes in in all four business areas. Revenue for Space Systems increased 31% to $2,550M in Q4 2020 from $1,951M in Q4 2019 due higher sales in Space and Launch & Strategic Missiles.

The company won $52.9B in contracts in 2020 with a book-to-bill ratio of 1.4 and a total backlog increased 25% to $81.0B at year end. Northrop Grumman is selling its IT Services business for $3.4B, which will be used for share buybacks and retiring debt. The company issued guidance of $35.1B to $35.5B in sales and $23.15 to $23.65 earnings per share in 2021 accounting for the divestment.

Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
EPS	$7.41	$7.81	$8.35	$9.75	$10.39	$12.19	$11.47	$21.33	$21.21	$23.65	***$23.40***	***$34.38***
DPS	$1.97	$2.15	$2.38	$2.71	$3.10	$3.50	$3.90	$4.70	$5.16	$5.67	***$5.80***	***$8.52***
Shares[1]	253.9	237.1	216.7	198.4	181.3	175.1	174.1	170.7	167	***164***	***160***	***145***

Northrop Grumman's earnings have increased substantially over time driven by top line growth from contract wins, modernization and upgrades, services, and acquisitions. 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, B-21 and other platforms. We reduced our estimate or average annual EPS growth to 8% out to 2026 due to a weaker outlook and U.S. budget uncertainties. The company is planning to retire debt early and conduct share buybacks with sale proceeds of IT Services. Northrop Grumman has paid a growing dividend for 17 years. The payout ratio is currently low at approximately 25% so there is room for further increases.

[1] Share count in millions.

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Valuation Analysis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
Avg. P/E	8.3	8.2	10.4	12.9	16.1	17.4	23.0	16.8	17.9	***12.4***	***12.5***	***15.0***
Avg. Yld.	3.2%	3.4%	2.7%	2.1%	1.9%	1.6%	1.5%	1.7%	1.7%	***1.9%***	***2.0%***	***1.7%***

Northrop Grumman's stock price fell further since our last report. The stock trades below our fair value multiple of 15X. The company beat revenue and earnings estimates in 2020 but issued soft revenue guidance for 2021. Our current fair value is now $351. Our current 5-year price target is now $516.

Safety, Quality, Competitive Advantage, & Recession Resiliency

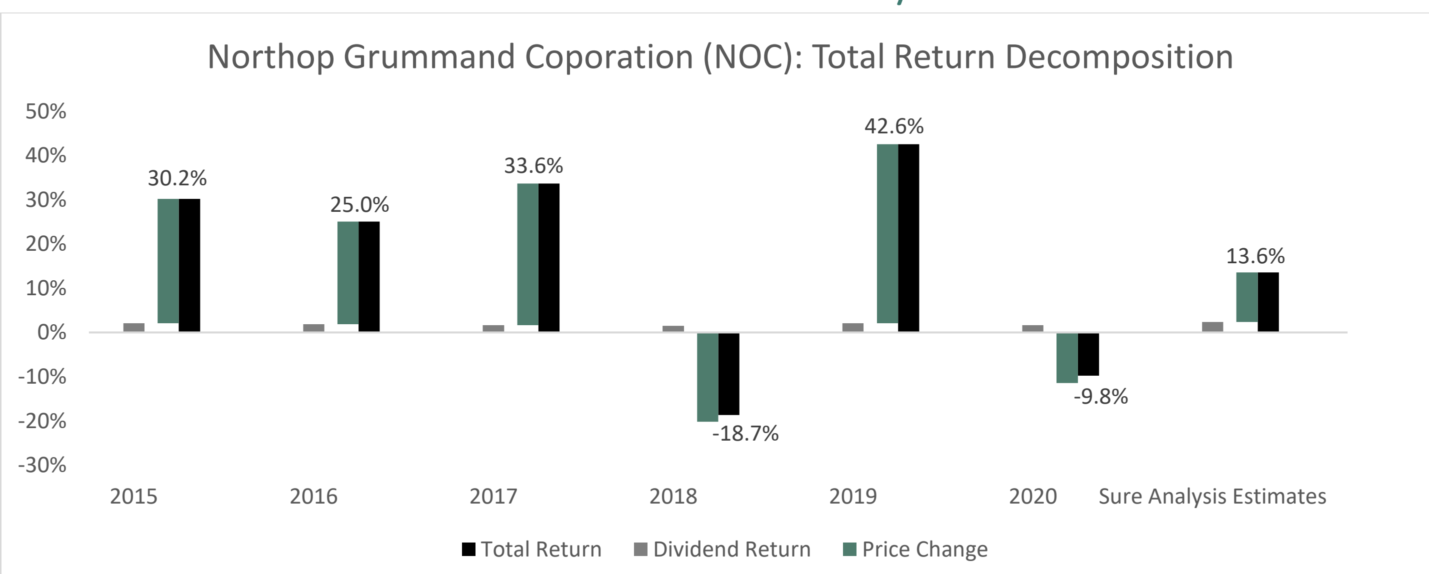
Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	27%	28%	29%	28%	30%	29%	34%	25%	24%	24%	***25%***	***25%***

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 and changing administrations 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. However, Northrop Grumman is now divesting the business. Debt has increased due to the Orbital ATK acquisition. Long-term debt is now at $14,261M offset by $4,907M in cash and equivalents. Interest coverage is 8X and the leverage ratio is down to 1.8X.

Final Thoughts & Recommendation

At present we are forecasting a 13.6% annualized total return through 2026. Northrop Grumman is facing a weaker outlook due to changing administrations and budget uncertainties. That said, many of Northrop Grumman's programs are priorities for the Pentagon. The backlog remains robust. The dividend yield is near the broader market average and the payout is very conservative. The weakness in stock price may be a good entry point and we rate this stock a buy.

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	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	26412	25218	24661	23979	23526	24706	26004	30095	33841	36799
Gross Profit	5626	5580	5379	5601	5642	5909	5930	6791	7259	7478
Gross Margin	21.3%	22.1%	21.8%	23.4%	24.0%	23.9%	22.8%	22.6%	21.5%	20.3%
SG&A Exp.	2350	2450	2256	2405	2566	2632	2712	3011	3290	3413
D&A Exp.	544	510	495	462	467	456	475	800	1018	1267
Operating Profit	3276	3130	3123	3196	3076	3277	3218	3780	3969	4065
Op. Margin	12.4%	12.4%	12.7%	13.3%	13.1%	13.3%	12.4%	12.6%	18.8%	11.0%
Net Profit	2118	1978	1952	2069	1990	2043	2869	3229	2248	3189
Net Margin	8.0%	7.8%	7.9%	8.6%	8.5%	8.3%	11.0%	10.7%	10.7%	8.7%
Free Cash Flow	1623	2309	2119	2032	1691	1893	1685	2578	3033	2885
Income Tax	997	987	911	868	800	638	1360	513	300	539

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets	25411	26543	26381	26572	24424	25614	35128	37653	41089	44469
Cash & Equivalents	3002	3862	5150	3863	2319	2541	11225	1579	2245	4907
Acc. Receivable	2964	2858	2685	2806	2841	3299	1054	1448	1326	1501
Inventories	873	798	698	742	807	816	398	654	783	759
Goodwill & Int.	12374	12431	12438	12466	12460	12450	12507	20044	19748	18301
Total Liabilities	15075	17029	15761	19337	18902	20355	27996	29466	32270	33890
Accounts Payable	1481	1392	1229	1305	1282	1554	1661	2182	2226	1806
Long-Term Debt	3935	3930	5928	5925	6386	7058	14399	13883	12770	14261
Total Equity	10336	9514	10620	7235	5522	5259	7132	8187	8819	10579
D/E Ratio	0.38	0.41	0.56	0.82	1.16	1.34	2.02	1.70	1.45	1.3

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets	7.5%	7.6%	7.4%	7.8%	7.8%	8.2%	9.4%	8.9%	5.7%	7.5%
Return on Equity	17.7%	19.9%	19.4%	23.2%	31.2%	37.9%	46.3%	42.2%	26.4%	32.9%
ROIC	13.0%	14.3%	13.0%	13.9%	15.9%	16.9%	17.0%	14.8%	10.3%	13.7%
Shares Out.	253.9	237.1	216.7	198.4	181.3	175.1	174.1	170	167	168
Revenue/Share	93.79	99.52	105.43	113.06	122.79	136.88	148.09	172.37	199.06	219.56
FCF/Share	5.76	9.11	9.06	9.58	8.83	10.49	9.60	14.77	17.84	17.21

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