Northrop Grumman Corporation (NOC)

Updated August 1st, 2023 by Prakash Kolli

Key Metrics

Current Price:	$445	**5 Year CAGR Estimate:**	5.4%	**Market Cap:**	$67.33B
Fair Value Price:	$362	**5 Year Growth Estimate:**	8.0%	**Ex-Dividend Date:**	08/26/23[1]
% Fair Value:	123%	**5 Year Valuation Multiple Estimate:**	-4.0%	**Dividend Payment Date:**	09/14/23
Dividend Yield:	1.7%	**5 Year Price Target**	$532	**Years Of Dividend Growth:**	20
Dividend Risk Score:	A	**Retirement Suitability Score:**	C	**Rating:**	Hold

Overview & Current Events

Northrop Grumman Corporation is one of the five largest US 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 (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 2018 and divested IT Services in 2021. 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 won the contract for the B-21 Raider. The company had revenue of over $36.6B in 2022.

Northrop Grumman reported results for Q2 FY 2023 on July 27th, 2023. Companywide revenue increased 9% to $9,576M from $8,801M and diluted adjusted earnings per share fell 12% to $5.34 from $6.06 on a year-over-year basis on lower margins. Revenue for Aeronautics Systems rose 2% to $2,595M from $2,534M in the prior year due to higher volumes in Manned Aircraft and Autonomous Systems offset by declines in E-2, F/A-18, and JSTARS. Revenue for Defense Systems rose 10% to $1,420M from $1,294M in comparable quarters due to higher sales in ammunition programs, the IBCS, HACM, and NATO AGS ISS. Revenue for Mission Systems increased 5% to $2,631M in the quarter from $2,596 in the prior year due to higher volumes on Networked Information Solutions, SEWIP, and marine systems, offset by G/ATOR. Revenue for Space Systems increased 17% to $3,488M in Q2 2023 from $2,979M in Q2 2022 from higher sales in several Launch & Strategic Missiles programs and in Space restricted programs offset by Commercial Resupply Services.

The total backlog is ~$78.8B at the end of the quarter of which $37.9B is funded. The firm won $10.9B for restricted programs including $5.4B for restricted programs. The book-to-bill ratio was 1.14.

The company guided for $38,400M to $38,800M in sales and $22.45 to $22.85 earnings per share in 2023.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
EPS	$8.35	$9.75	$10.39	$12.19	$11.47	$21.33	$21.21	$23.65	$25.63	$25.54	***$22.65***	***$33.28***
DPS	$2.38	$2.71	$3.10	$3.50	$3.90	$4.70	$5.16	$5.67	$6.28	$6.76	***$7.48***	***$10.99***
Shares[2]	217	198	181	175	174	171	167	167	156	153	***150***	***136***

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 the 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-2, E2-2D, B-21, and space platforms. We reduced our estimate of average annual EPS growth to 8% out to 2028 due to U.S. budget uncertainties and higher costs. The company retired debt early and conducted share buybacks with sale proceeds of the IT Services segment. Northrop Grumman has paid a growing dividend for 20 years. The payout ratio is currently low at approximately 33% so there is room for further increases.

[1] Estimated based on prior years. Northrop Grumman has not yet announced the next quarterly dividend.
[2] Share count in millions.

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Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
Avg. P/E	10.4	12.9	16.1	17.4	23.0	16.8	17.9	13.8	13.6	18.3	***19.6***	***16.0***
Avg. Yld.	2.7%	2.1%	1.9%	1.6%	1.5%	1.7%	1.7%	1.7%	1.8%	1.4%	***1.7%***	***2.1%***

Northrop Grumman's stock price is down since our last report despite decent performance. We raised our 2023 earnings estimate to the mid-point of updated guidance. The stock trades higher than our fair value multiple of 16X, the trailing 10-year average. Our current fair value is now $362. Our current 5-year price target is now $532.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	29%	28%	30%	29%	34%	25%	24%	24%	25%	26%	***33%***	***33%***

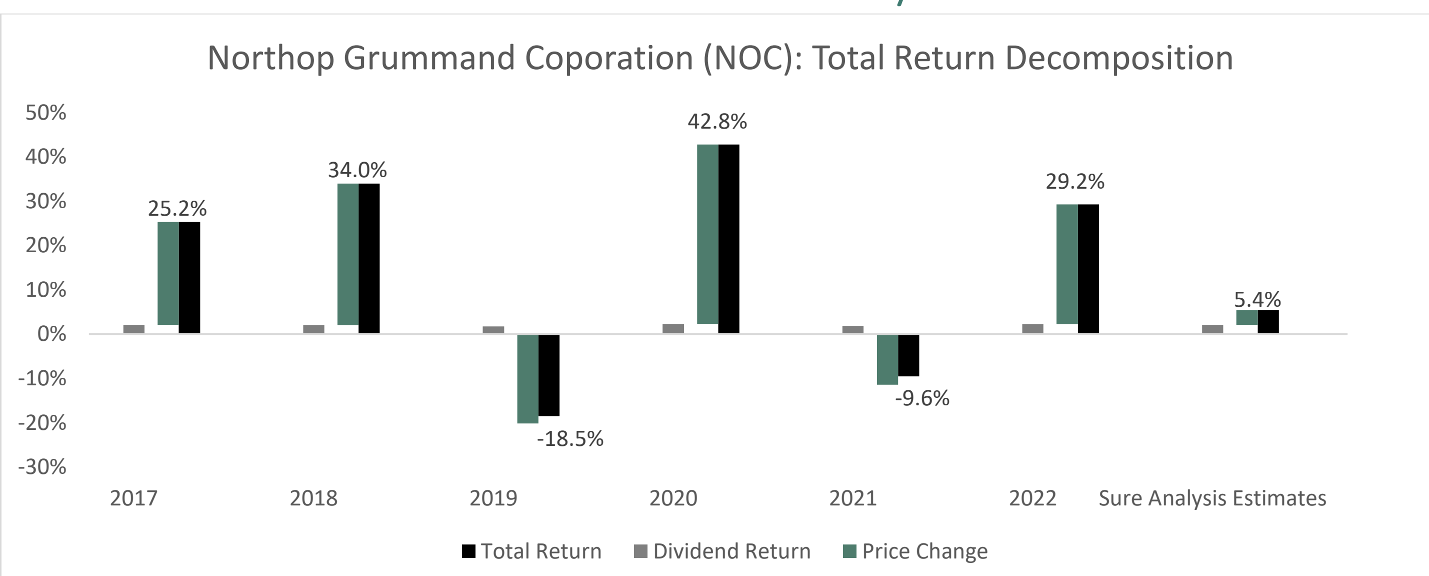
As a prime US defense contractor, Northrop Grumman has an entrenched position in many of its end markets. Of note are the B-2, B-21, E-2D, E-8C, Global Hawk and Triton platforms. Few companies have the technical expertise and classified workforce to build these platforms. In addition, these platforms 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 caused by new priorities to the defense budget.

Debt increased due to the Orbital ATK acquisition, which the company is paying down. Long-term debt is now at $13,796M offset by $3,384M in cash and equivalents. Interest coverage is 11.4X and the leverage ratio is down to 1.8X.

Final Thoughts & Recommendation

At present we are forecasting a 5.4% annualized total return through 2028 from a dividend yield of 1.7%, 8% EPS growth, and (-4.0%) P/E multiple contraction. The company's balance sheet is solid, and the credit rating was upgraded. The Space segment is rapidly growing. The dividend yield is low, but the dividend safety is high as illustrated by the low payout ratio and reasonable debt. The share price has weakened on lower profits, notwithstanding higher revenue. We maintained our rating of this high-quality stock at 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	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	24661	23979	23526	24706	26004	30095	33841	36799	35667	36602
Gross Profit	5379	5601	5642	5909	5930	6791	7259	7478	7268	7474
Gross Margin	21.8%	23.4%	24.0%	23.9%	22.8%	22.6%	21.5%	20.3%	20.4%	20.4%
SG&A Exp.	2256	2405	2566	2632	2712	3011	3290	3413	3597	3873
D&A Exp.	495	462	467	456	475	800	1018	1267	1239	1342
Operating Profit	3123	3196	3076	3277	3218	3780	3969	4065	3671	3601
Op. Margin	12.7%	13.3%	13.1%	13.3%	12.4%	12.6%	18.8%	11.0%	10.3%	9.8%
Net Profit	1952	2069	1990	2043	2869	3229	2248	3189	7005	4896
Net Margin	7.9%	8.6%	8.5%	8.3%	11.0%	10.7%	10.7%	8.7%	19.6%	13.4%
Free Cash Flow	2119	2032	1691	1893	1685	2578	3033	2885	2152	1466
Income Tax	911	868	800	638	1360	513	300	539	1933	940

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	26381	26572	24424	25614	35128	37653	41089	44469	42579	43755
Cash & Equivalents	5150	3863	2319	2541	11225	1579	2245	4907	3530	2577
Acc. Receivable	2685	2806	2841	3299	1054	1448	1326	1501	1467	1511
Inventories	698	742	807	816	398	654	783	759	811	978
Goodwill & Int.	12438	12466	12460	12450	12507	20044	19748	18301	18090	17900
Total Liabilities	15761	19337	18902	20355	27996	29466	32270	33890	29653	28443
Accounts Payable	1229	1305	1282	1554	1661	2182	2226	1806	2197	2587
Long-Term Debt	5928	5925	6386	7058	14399	13883	12770	14261	12777	12877
Total Equity	10620	7235	5522	5259	7132	8187	8819	10579	12930	15312
D/E Ratio	0.56	0.82	1.16	1.34	2.02	1.70	1.45	1.3	0.99	0.84

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	7.4%	7.8%	7.8%	8.2%	9.4%	8.9%	5.7%	7.5%	16.1%	11.3%
Return on Equity	19.4%	23.2%	31.2%	37.9%	46.3%	42.2%	26.4%	32.9%	59.6%	34.7%
ROIC	13.0%	13.9%	15.9%	16.9%	17.0%	14.8%	10.3%	13.7%	27.3%	18.2%
Shares Out.	216.7	198.4	181.3	175.1	174.1	170	167	168	161	156
Revenue/Share	105.43	113.06	122.79	136.88	148.09	172.37	199.06	219.56	221.67	235.23
FCF/Share	9.06	9.58	8.83	10.49	9.60	14.77	17.84	17.21	13.37	9.42

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