

Huntington Ingalls(HII)

\$276.47 (As of 01/24/20)

Price Target (6-12 Months): **\$293.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 01/27/20)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

4-Sell

Zacks Style Scores:

VGM:B

Value: B

Growth: C

Momentum: B

Summary

Huntington Ingalls is the sole designer and manufacturer of nuclear powered aircraft carriers in the United States. Furthermore, over 70% of the active U.S. Navy fleet consists of Huntington Ingalls ships. Being the nation's largest military shipbuilder, the company boasts stable financials. Fiscal 2020 budget should boost the company's growth trajectory. The company's SSN-794 Montana submarine delivery is on track to achieve pressure hull complete by end of 2019. Also, Huntington Ingalls has outperformed its industry in a year's time. However, the company's exposure to debt combined with its ability to incur significant amounts of debt in the future increases its vulnerability to adverse economic or industry conditions. Additionally, reduced fleet size poses risk for its growth potential.

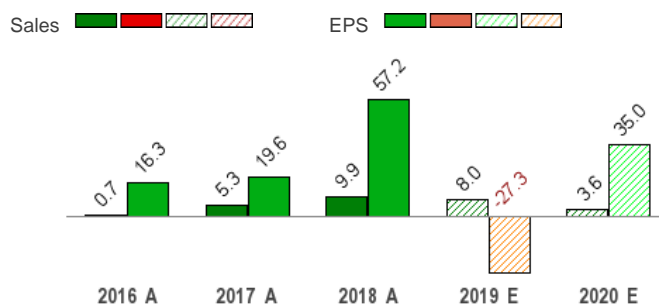
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$279.71 - \$196.26
20 Day Average Volume (sh)	314,427
Market Cap	\$11.3 B
YTD Price Change	10.2%
Beta	1.21
Dividend / Div Yld	\$4.12 / 1.5%
Industry	Aerospace - Defense
Zacks Industry Rank	Top 44% (112 out of 255)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	3.0%
Last Sales Surprise	1.0%
EPS F1 Est- 4 week change	-0.1%
Expected Report Date	02/13/2020
Earnings ESP	-1.8%
P/E TTM	18.9
P/E F1	14.8
PEG F1	NA
P/S TTM	1.3

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2020					9,145 E
2019	2,080 A	2,188 A	2,219 A	2,339 E	8,826 E
2018	1,874 A	2,020 A	2,083 A	2,199 A	8,176 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2020					\$18.73 E
2019	\$2.85 A	\$3.07 A	\$3.74 A	\$4.24 E	\$13.87 E
2018	\$3.48 A	\$5.40 A	\$5.29 A	\$4.94 A	\$19.09 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 01/24/2020. The reports text is as of 01/27/2020.

Overview

Based in Newport News, VA, **Huntington Ingalls Industries** designs, builds and maintains nuclear-powered ships such as aircraft carriers and submarines, and non-nuclear ships, such as surface combatants, expeditionary warfare/amphibious assault and coastal defense surface ships for the U.S. Navy and Coast Guard and provides after-market services for military ships around the globe.

Currently, Huntington Ingalls operates through three segments: Ingalls, Newport News and Technical Solutions.

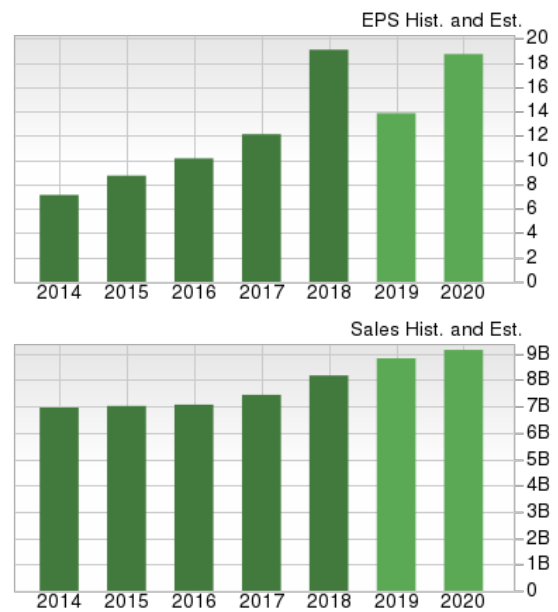
Ingalls – The segment manufactures amphibious assault and expeditionary ships for the U.S. Navy. The division is the only builder of National Security Cutters (“NSCs”) for the U.S. Coast Guard and one of only two companies that builds the Navy's current fleet of DDG-51 Arleigh Burke -class destroyers. It generated revenues of \$2,607 million in 2018, representing 31.9% of total revenues.

Through its **Newport News** segment, the company is the nation's sole designer, builder and refueler of nuclear-powered aircraft carriers. It is also one of only two companies currently designing and building nuclear-powered submarines for the U.S. Navy. The segment generated revenues of \$4,722 million in 2018, representing 57.8% of total revenues.

The **Technical Solutions** segment provides a wide range of professional services through its fleet support, integrated missions solutions, nuclear and environmental, and oil and gas operations. It generated revenues of \$988 million in the 2018, representing 12.1% of total revenues.

Total revenues included intersegment eliminations worth \$141 million.

As of Sep 30, 2019, the company's total backlog was \$39.2 billion, significantly higher than \$23 billion at 2018 end.



Reasons To Buy:

▲ **Largest U.S. Military Shipbuilder & Recent Uptick:** The company is the prime industrial employer in Virginia. It is the sole designer and manufacturer of nuclear powered aircraft carriers in the U.S. Over 70% of the active U.S. Navy fleet consists of Huntington Ingalls ships. Notably, Huntington Ingalls ended the third quarter on a solid note, generating revenues worth \$2.22 billion that reflected a year-over-year improvement of 6.5%. Coming to the quarterly updates, the company's CVN 79 Kennedy is approximately 67% complete and is on track for its scheduled launch in the fourth quarter of 2019. CVN 73 USS George Washington has been undocked in the third quarter, in line with earlier announced plan. Moreover, the company completed acceptance trials on LHA-7 Tripoli, which is on track for delivery in late 2019 or early 2020. Huntington Ingalls also redelivered USS Gerald R. Ford to the Navy in the third quarter. Further, it launched NSC 9 Stone in early October, with its external structural work being completed in July.

The company is the largest player of the nation's shipbuilding industry. Its stable financials, return of cash to shareholders and solid budget outlook are added positives.

In the submarine program, Huntington Ingalls delivered SSN 791 in late October, in line with its planned delivery in the third quarter of 2019. Moreover, SSN-794 Montana, the first Block IV delivery is on track to achieve pressure hull completion in December, with delivery planned for the first half of 2021. And finally, the Block V contract is on track for award by the end of this year. On successful completion, such notable programs should boost the company's top line.

▲ **Positive Budget & Backlog:** The shipbuilding business outlook remains strong, given the fiscal 2020 defense budget proposal that represented the biggest budget request in more than 20 years for shipbuilding. The latest budget includes a solid spending plan worth \$34.7 billion on shipbuilding. No doubt, one of the prime beneficiaries of this new spending proposal will be Huntington Ingalls. For more than 100 years, this company has been building ships, aircraft carriers and submarines for the U.S. Navy at their shipyards in Virginia and Mississippi. The fiscal 2020 budget includes funding worth \$2.2 billion for Columbia Class Submarine and \$2.6 billion for CVN-78.

During the third quarter, Huntington Ingalls secured \$2.1 billion in new contracts, which resulted in total backlog of \$39.2 billion as of Sep 30, 2019. Such significant backlog count indicates solid revenue growth for the company.

▲ **Stable Financials:** Huntington Ingalls maintains stable liquidity and capital resources to fund its operations. This in turn must have allowed Huntington Ingalls to be on with its schedule to invest \$1.8-\$1.9 billion in its shipyards, increase its dividend at least 10% annually through 2020 and utilize share buybacks to return all free cash flow to its shareholders from 2016 through 2020. Keeping up with this trend, the company raised its dividend by 19.7% to \$1.03 as well as its share repurchase program from \$2.2 billion to \$3.2 billion in November 2019. This reflects Huntington Ingalls' solid cash generating capacity. Moreover, during the third quarter of 2019, the company returned \$68 million through share repurchases and paid dividends worth \$35 million to its investors, as the company focuses on maximizing shareholder value.

Such solid financial position may have boosted investors' confidence in this stock. As a result, Huntington Ingalls outperformed its industry in a year's time. Shares of the company have gained 37.4% compared with its industry's 16.2% growth.

Reasons To Sell:

- ▼ **Reduced Fleet Size:** Given uncertain and unpredictable U.S. defense spending levels, any reduction in shipbuilding activity by the U.S. Navy will result in fewer contracts to the same fixed number of shipyards. Notably, fleet size has been reduced from 566 ships in 1989 to 287 ships as of Dec 31, 2018. Consequently, fewer contracts are awarded to the same fixed number of shipyards, which has resulted in workforce reduction in the industry. Obviously, this is not an encouraging scenario for shipbuilders like Huntington Ingalls.
- ▼ **Intense Competition:** In its primary business of designing, building, overhauling, and repairing military ships, the company primarily competes with General Dynamics Corp. Among the six major private U.S. shipyards, Huntington Ingalls owns three while there are numerous smaller private shipyards that compete for contracts. Again, Huntington Ingalls' products, such as aircraft carriers, submarines, amphibious assault ships, surface combatants, and other ships, compete for funding with each other, as well as with other defense products and services. More competitive pressure is brewing up for future shipbuilding programs that might hurt the company's profit.
- ▼ **Exposure to Debt:** As of Dec 31, 2018, Huntington Ingalls had \$1.3 billion of debt. Such debt levels, combined with the company's ability to incur significant amounts of debt in the future, increases its vulnerability to adverse economic or industry conditions. Moreover, it will require the company to dedicate a portion of its cash flow from operations to repayments of debt, thereby reducing the availability of cash flow to fund working capital, capital expenditures as well as strategic initiatives. In fact, such high debt levels may have pushed up the debt-to-equity ratio for the company and kept it higher than that of the broader market. Notably, the company's current debt-to-equity ratio stands at 100.94, while that of the S&P 500 Index's stands at 91.86. This might remain a concern for those investing in this stock.

Competitive pressure and extensive exposure to debt may hurt Huntington Ingalls' profit.

Last Earnings Report

Huntington Ingalls Q3 Earnings Beat, Revenues Up Y/Y

Huntington Ingalls' third-quarter 2019 earnings of \$3.74 per share surpassed the Zacks Consensus Estimate of \$3.63 by 3%. However, the bottom line decreased 29.3% from the \$5.29 registered in the prior-year quarter.

This year-over-year decline resulted from lower operating income, an unfavorable change in the non-operating retirement benefit and a lower non-operating retirement benefit compared with the prior year.

Quarter Ending **09/2019**

Report Date	Nov 07, 2019
Sales Surprise	1.00%
EPS Surprise	3.03%
Quarterly EPS	3.74
Annual EPS (TTM)	14.60

Total Revenues

Total revenues came in at \$2,219 million, outpacing the Zacks Consensus Estimate of \$2,197 million by 1%. The top line also increased 6.5% from the year-ago quarter's \$2,083 million. Higher volume in the Newport News Shipbuilding division and growth in the Technical Solutions division, on account of the recent acquisitions, led to the upside.

Segment Details

Newport News Shipbuilding: Revenues totaled \$1,264 million in this segment, up 7.2% year over year, backed by higher revenues from aircraft carriers and submarines.

Meanwhile, operating income declined 8.4% to \$109 million due to a workers' compensation benefit of \$43 million recorded in the year-ago quarter.

Ingalls Shipbuilding: This segment's top-line figure slipped 6.8% to \$647 million on account of lower revenues from the Legend-class National Security Cutter (NSC) program and amphibious assault ships.

Also, operating income declined 25.6% to \$61 million, primarily due to lower risk retirement on the LPD program.

Technical Solutions: Revenues in this segment summed \$347 million, up 41.6% year over year. The upswing was driven by the acquisitions of G2, Inc. and Fulcrum IT Services, as well as organic growth in fleet support, and oil and gas service revenues.

This segment recorded an operating income of \$21 million compared with the operating income of \$16 million reported in the year-ago quarter.

Backlog

Huntington Ingalls received new orders worth \$2.1 billion in the third quarter. As a result, the company's total backlog reached \$39.2 billion as of Sep 30, 2019, compared with \$41 billion as of Mar 31, 2019.

Financial Update

Cash and cash equivalents as of Sep 30, 2019, were \$32 million, significantly down from \$240 million as of Dec 31, 2018.

Long-term debt, as of Sep 30, 2019, was \$1,549 million compared with the 2018-end level of \$1,283 million.

Cash inflow from operating activities, at the end of third-quarter 2019, grossed \$330 million compared with the cash inflow of \$266 million recorded at the end of third-quarter 2018.

Valuation

Huntington Ingalls' shares are up 19.2% in the past six months period and 37.4% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Aerospace sector are up 4.7% and 8.1% in the past six months period, respectively. Over the past year, the Zacks sub-industry and sector are up 16.2% and 23.5%, respectively.

The S&P 500 index is up 10.6% in the past six months period and 26.6% in the past year.

The stock is currently trading at 14.68X forward 12-month earnings, which compares to 18.45X for the Zacks sub-industry, 18.37X for the Zacks sector and 19.15X for the S&P 500 index.

Over the past five years, the stock has traded as high as 21.32X and as low as 10.5X, with a 5-year median of 14.5X. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$293 price target reflects 15.56X earnings value.

The table below shows summary valuation data for HII

Valuation Multiples - HII					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	14.68	18.45	18.37	19.15
	5-Year High	21.32	22.54	21.54	19.34
	5-Year Low	10.5	14.52	14.26	15.17
	5-Year Median	14.5	17.09	16.82	17.44
P/S F12M	Current	1.23	1.53	1.33	3.56
	5-Year High	1.6	1.64	1.39	3.56
	5-Year Low	0.71	0.95	0.8	2.54
	5-Year Median	1.11	1.25	1.06	3
EV/EBITDA TTM	Current	13.36	14.27	12.94	12.38
	5-Year High	13.36	15.01	13.24	12.86
	5-Year Low	5.41	8.3	7.28	8.48
	5-Year Median	8.91	11.53	9.95	10.69

As of 01/24/2020

Industry Analysis Zacks Industry Rank: Top 44% (112 out of 255)



Top Peers

Euronav NV (EURN)	Outperform
Leidos Holdings, Inc. (LDOS)	Outperform
Ardmore Shipping Corporation (ASC)	Neutral
Bae Systems PLC (BAESY)	Neutral
General Dynamics Corporation (GD)	Neutral
Hexcel Corporation (HXL)	Neutral
Lockheed Martin Corporation (LMT)	Neutral
Northrop Grumman Corporation (NOC)	Neutral

Industry Comparison Industry: Aerospace - Defense				Industry Peers		
	HII Neutral	X Industry	S&P 500	GD Neutral	LMT Neutral	NOC Neutral
VGM Score	B	-	-	C	B	B
Market Cap	11.31 B	12.85 B	24.13 B	53.54 B	122.00 B	64.32 B
# of Analysts	5	5.5	13	9	9	8
Dividend Yield	1.49%	0.88%	1.78%	2.20%	2.22%	1.38%
Value Score	B	-	-	B	C	C
Cash/Price	0.00	0.02	0.04	0.02	0.02	0.02
EV/EBITDA	10.52	13.96	14.02	11.83	17.23	15.35
PEG Ratio	NA	2.28	2.03	1.67	2.51	1.27
Price/Book (P/B)	6.74	4.75	3.30	3.96	30.99	6.61
Price/Cash Flow (P/CF)	11.39	16.10	13.52	12.76	19.45	14.32
P/E (F1)	14.66	18.38	18.92	14.35	17.83	16.60
Price/Sales (P/S)	1.30	1.35	2.65	1.37	2.09	1.93
Earnings Yield	6.77%	5.36%	5.28%	6.96%	5.61%	6.02%
Debt/Equity	1.01	0.67	0.72	0.67	3.21	1.55
Cash Flow (\$/share)	24.28	5.28	6.94	14.51	22.24	26.65
Growth Score	C	-	-	C	A	B
Hist. EPS Growth (3-5 yrs)	21.50%	12.53%	10.60%	7.41%	14.78%	22.40%
Proj. EPS Growth (F1/F0)	35.09%	14.18%	7.59%	8.17%	12.11%	12.77%
Curr. Cash Flow Growth	35.98%	20.42%	13.90%	20.42%	24.70%	61.17%
Hist. Cash Flow Growth (3-5 yrs)	15.61%	7.81%	9.00%	6.79%	6.70%	14.12%
Current Ratio	1.04	1.16	1.22	1.11	1.28	1.29
Debt/Capital	50.23%	43.20%	42.99%	39.95%	76.27%	60.86%
Net Margin	7.05%	6.46%	11.35%	8.66%	10.26%	9.05%
Return on Equity	38.18%	19.00%	17.10%	26.79%	221.59%	39.12%
Sales/Assets	1.25	0.91	0.55	0.82	1.23	0.84
Proj. Sales Growth (F1/F0)	3.61%	4.85%	4.03%	4.41%	5.30%	5.34%
Momentum Score	B	-	-	F	C	F
Daily Price Chg	-0.23%	0.02%	-1.01%	0.24%	0.87%	0.04%
1 Week Price Chg	2.54%	2.15%	2.29%	1.33%	2.86%	1.49%
4 Week Price Chg	9.45%	2.97%	1.02%	3.86%	10.25%	9.68%
12 Week Price Chg	22.52%	8.18%	6.85%	4.68%	14.82%	8.27%
52 Week Price Chg	38.89%	39.82%	20.39%	8.34%	51.62%	41.44%
20 Day Average Volume	314,427	567,491	1,536,379	1,144,031	1,089,082	953,738
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	-0.02%	0.00%	0.25%
(F1) EPS Est 4 week change	-0.12%	0.00%	0.00%	-0.15%	0.00%	-0.08%
(F1) EPS Est 12 week change	15.73%	-0.63%	-0.23%	-0.94%	-0.63%	0.98%
(Q1) EPS Est Mthly Chg	NA%	0.17%	0.00%	0.33%	4.48%	0.92%

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	B
Growth Score	C
Momentum Score	B
VGM Score	B

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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