

Huntington Ingalls(HII)

\$153.89 (As of 08/26/20)

Price Target (6-12 Months): **\$163.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 01/27/20)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

5-Strong Sell

Zacks Style Scores:

VGM:A

Value: A

Growth: B

Momentum: A

Summary

Huntington Ingalls reported dismal second-quarter results, with both its earnings and revenues lagging the respective Zacks Consensus Estimate. It is the sole designer and manufacturer of nuclear-powered aircraft carriers in the United States. The shipbuilding business outlook remains strong, given the proposed fiscal 2021 defense budget, which in turn is benefiting the stock. Huntington Ingalls' shares have outperformed the industry in a year. However, the company has been incurring notable expenses due to the COVID-19 impacts that may weigh on its bottom-line performance. In January 2020, the Trump administration announced plans to expand its existing tariffs on imports of steel and aluminum, starting Feb 8. This is likely to escalate costs and disrupt the supply chain, thereby hurting Huntington Ingalls' growth prospects.

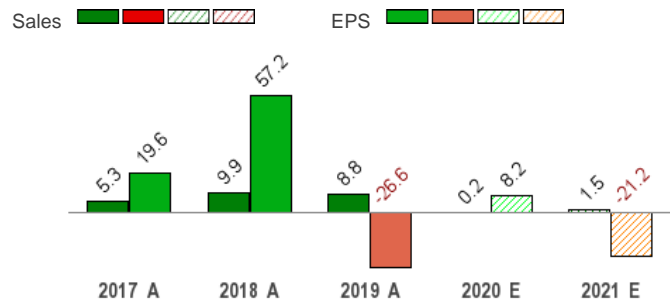
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$279.71 - \$147.14
20 Day Average Volume (sh)	373,173
Market Cap	\$6.2 B
YTD Price Change	-38.7%
Beta	1.04
Dividend / Div Yld	\$4.12 / 2.7%
Industry	Aerospace - Defense
Zacks Industry Rank	Bottom 11% (224 out of 252)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	-68.8%
Last Sales Surprise	-5.3%
EPS F1 Est- 4 week change	-18.4%
Expected Report Date	11/05/2020
Earnings ESP	-3.1%

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	2,218 E	2,178 E	2,291 E	2,425 E	9,051 E
2020	2,263 A	2,027 A	2,212 E	2,373 E	8,913 E
2019	2,080 A	2,188 A	2,219 A	2,412 A	8,899 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$3.10 E	\$3.03 E	\$3.18 E	\$3.49 E	\$11.95 E
2020	\$4.23 A	\$1.30 A	\$4.31 E	\$5.00 E	\$15.16 E
2019	\$2.85 A	\$3.07 A	\$3.74 A	\$4.36 A	\$14.01 A

*Quarterly figures may not add up to annual.

P/E TTM	13.0
P/E F1	10.2
PEG F1	0.3
P/S TTM	0.7

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 08/26/2020. The reports text is as of 08/27/2020.

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 division, Newport News Shipbuilding division and Technical Solutions division.

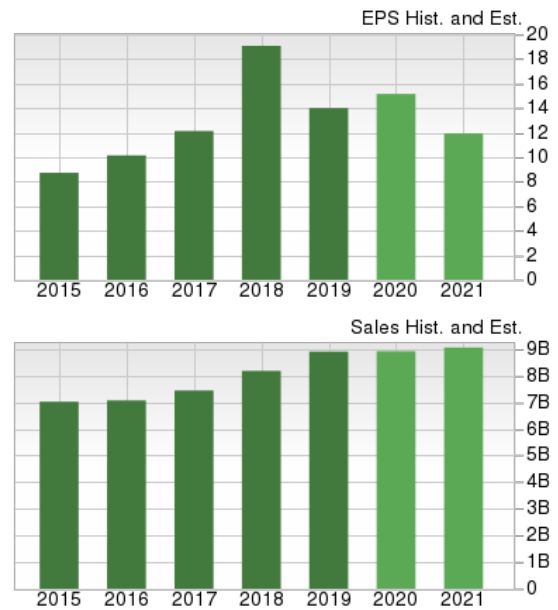
Ingalls – The company's Ingalls segment manufactures amphibious assault and expeditionary ships for the U.S. Navy. The division is the only builder of National Security Cutters ("NSCs") for the U.S. Coast Guard and one of only two companies that builds the Navy's current fleet of DDG-51 Arleigh Burke -class destroyers. It generated revenues of \$2,555 million in 2019, representing 28.2% 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 \$5,186 million in 2019, representing 57.3% 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 \$1,309 million in the 2019, representing 14.5% of total revenues.

Total revenues included intersegment eliminations worth \$151 million.

As of Dec 31, 2019, Huntington Ingalls' total backlog was \$46.5 billion, significantly higher than \$23 billion registered at the end of 2018.



Reasons To Buy:

- ▲ **Largest U.S. Military Shipbuilder & Recent Uptick:** Huntington Ingalls 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.

Coming to the quarterly updates, the company's CVN 79 Kennedy is approximately 74% complete and it remains focused on compartment completion and preparation for primary system testing. Its CVN 73 USS George Washington is consistently progressing through its final outfitting and test phase and is approximately 78% complete. Meanwhile, DDG 119 Delbert D. Black was delivered to the U.S. Navy, while production was started for DDG 128 Ted Stevens. On the other hand, NSC 9 Stone continues to progress through the test program and is expected to be delivered by end of 2020. On successful completion, such notable programs should boost the company's top line.

The company is the largest player of the nation's shipbuilding industry. Its stable financials, impressive backlog count and solid budget outlook are added positives.

- ▲ **Positive Budget & Backlog:** The shipbuilding business outlook remains strong, given the proposed fiscal 2021 defense budget inclusion of a solid spending plan worth \$32.3 billion on shipbuilding. Additionally, the proposed fiscal 2021 budget includes funding worth \$4.4 billion for one Columbia Class Ballistic Missile Submarine and \$3 billion for one CVN-78 FORD Class Aircraft Carrier. No doubt, Huntington Ingalls will be significant beneficiaries of such spending proposals. 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 value of new contract awards that the company won in second-quarter 2020 was approximately \$3 billion, which resulted in a total backlog of \$46 billion as of Jun 30, 2020, of which approximately \$21 billion is funded. Such significant backlog count indicates solid revenue growth for the company.

- ▲ **Stable Financials:** Huntington Ingalls' cash and cash equivalents at the end of second quarter 2020 were \$631 million, up from \$28 million at the end of the first quarter. The company's long-term debt as of Jun 30, 2020, was \$2,423 million, increasing sequentially from \$1,820 million. Although the long-term debt level lies much above the company's cash reserve, the company's current ratio as of Jun 30, 2020 of 1.30 indicates that it has sufficient capital in hand to meet its short-term obligations. The current ratio also increased sequentially from 1.03 and was the highest in the last four quarters. Further, Huntington Ingalls' debt-to-capital ratio of 0.59 remained below the industry's level of 0.87. These favorable ratios make us optimistic about the company's ability to meet debt obligations in the near future.

Such a solid financial position might have boosted investors' confidence in this stock. As a result, Huntington Ingalls outperformed the industry in a year's time. Shares of the company have lost 24.5% compared with the industry's 29% decline.

Reasons To Sell:

- ▼ **Tariff Impact:** In January 2020, the Trump administration announced plans to expand its existing tariffs on imports of steel and aluminum, starting Feb 8. Steel and aluminum derivatives will also come under the tariff mandate. This tariff expansion is expected to deal a heavy blow to the U.S. aerospace and defense industry, which relies heavily on imported aluminum. In 2018, when the initial tariff was imposed, the AIA had expressed concerns by saying that such a tariff will raise costs and disrupt the supply chain. Now that tariffs are being imposed on derivatives as well, the growth prospects for manufacturing-oriented stocks like Huntington Ingalls seem bleak.
- ▼ **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 have a negative impact on the company's profit.
- ▼ **COVID-19 Impacts:** Huntington Ingalls incurred and expects to incur costs related to COVID-19 events, including paid leave, quarantining employees and recurring facility cleaning. This might weigh on its bottom-line performance. While its shipyards and other facilities remain open and productive, the company experienced a decrease in workforce attendance. This impacted its operations given the lack of availability of critical skills and out-of-sequence work. In the second quarter, the company recognized across all its programs an aggregate unfavorable impact on operating margin of \$61 million for delay and disruption attributable to COVID-19 events.

Moreover, the company fears that continued lower staffing levels and lower employee productivity might impact its ability to achieve anticipated milestones and further affect its financial results in 2020 and beyond. To tackle the situation, the company has also been forced to temporarily halt stock repurchases and will continue to reassess when to initiate repurchases. Since the pandemic is unlikely to die out anytime soon, its impacts are expected to be a major growth inhibitor for the company going ahead.

Competitive pressure and impact of the coronavirus outbreak may hurt Huntington Ingalls' profit.

Last Earnings Report

Huntington Ingalls Q2 Earnings Miss, Revenues Drop Y/Y

Huntington Ingalls second-quarter 2020 earnings of \$1.30 per share missed the Zacks Consensus Estimate of \$4.16 by 69%. Moreover, the bottom line declined 57.8% from \$3.07 reported in the prior-year quarter.

Total Revenues

Total revenues came in at \$2.03 billion, lagging the Zacks Consensus Estimate of \$2.14 billion by 5.3%. The top line also declined 7.4% from \$2.19 billion in the year-ago quarter. The decrease was primarily due to revenue loss at the Newport News and Technical Solutions divisions.

Operational Performance

Huntington Ingalls incurred total operating loss of \$5 million against operating income of \$138 million in the second quarter of 2019.

Huntington Ingalls received orders worth \$2.9 billion during the second quarter. As a result, the company's total backlog reached \$46.1 billion as of Jun 30, 2020.

Segmental Performance

Newport News Shipbuilding: Revenues totaled \$1,122 million at this segment, down 12.3% year over year, on account of lower revenues from aircraft carriers and submarine construction.

Meanwhile, the segment incurred operating loss of \$69 million against operating income of \$71 million in the year-ago quarter. This downside was due to unfavorable cumulative catch-up adjustments on Block IV boats of the Virginia-class submarine program as well as the impact of discrete COVID-19 delay and disruption.

Ingalls Shipbuilding: Revenues at this segment remained flat at \$622 million, as higher revenues from the Legend-class National Security Cutter (NSC) program, the San Antonio-class LPD program and the America-class LHA program were offset by lower revenues from the Arleigh Burke-class DDG program.

Also, operating income declined 20.3% to \$55 million, while operating margin contracted 225 basis points(bps) to 8.8%. These decreases were on account of unfavorable adjustments, including delay and disruption from COVID-19 and lower risk retirement on the Legend-class NSC program.

Technical Solutions: Revenues at this segment slipped 0.3% to \$320 million on account of lower mission driven innovative solutions (MDIS), fleet support and nuclear and environmental services revenues.

The segment's operating income was \$9 million against operating loss of \$2 million in second-quarter 2019.

Financial Update

Cash and cash equivalents as of Jun 30, 2020 were \$631 million, significantly up from \$75 million as of Dec 31, 2019.

Long-term debt, as of Jun 30, 2020, was \$2,276 million compared with the 2019-end level of \$1,286 million.

Cash from operating activities, at the end of second-quarter 2020, grossed \$269 million against cash used worth \$33 million at the end of second-quarter 2019.

Quarter Ending 06/2020

Report Date	Aug 06, 2020
Sales Surprise	-5.25%
EPS Surprise	-68.75%
Quarterly EPS	1.30
Annual EPS (TTM)	13.63

Recent News

On Jul 22, 2020, Huntington Ingalls announced that its Technical Solutions division has completed a strategic equity investment in Sea Machines Robotics, Inc., a Boston-based autonomous technology company that specializes in advanced software for unmanned surface vessels (USVs). This will enhance Huntington Ingalls' position in the unmanned systems market.

On **Jul 13, 2020**, Huntington Ingalls secured a modification contract for USS Helena (SSN 725). The deal has been awarded by the Supervisor of Shipbuilding, Conversion and Repair, USN, Newport News, VA.

Valued at \$35.3 million, the contract is projected to be completed by October 2020. Huntington Ingalls will execute repair, maintenance, upgrades and modernization efforts on the USS Helena dry-docking selected restricted availability (DSRA).

On **Jul 3, 2020**, Huntington Ingalls' Newport News Shipbuilding division secured a modification contract for providing engineering, technical, trade and program management support for operational and decommissioning submarines and special mission submersibles. The contract, value at \$36.6 million, has been awarded by the Naval Sea Systems Command, Washington, D.C.

On **Jun 29, 2020**, Huntington Ingalls Industries secured a modification contract to exercise the fiscal 2020 option for the construction of a USS Arleigh Burke DDG-51 class ship. Work related to the deal is scheduled to be over by June 2027. Valued at \$936 million, the contract was awarded by the Naval Sea Systems Command, Washington, D.C.

On **Jun 18, 2020**, Huntington Ingalls' unit, Ingalls Shipbuilding, secured a third modification contract, worth \$145.6 million, to provide long-lead-time material and advance procurement activities for amphibious assault ship LHA 9 class. The contract was awarded by the Naval Sea Systems Command, Washington, D.C. The modification now brings the total advance funding for LHA 9 to \$350 million.

Per the deal terms, Huntington Ingalls will procure long-lead-time material for LHA 9, the fourth LHA(R) America Class amphibious assault warships and the second LHA(R) Flight 1 variant. The majority of work related to this deal will be performed in Milwaukee, WI; Baltimore, MD; and Pascagoula, MS. The entire task related to the deal is scheduled to be completed by February 2024.

On **Jun 5, 2020**, Huntington Ingalls announced that its Shipbuilding division moved destroyer Delbert D. Black (DDG 119) to Pier Four on the east bank of the Pascagoula River today, signifying the reopening of a facility decimated in Hurricane Katrina.

The newly reactivated, 187-acre east bank features covered construction areas to improve safety and optimize ship assembly, expansive storage facilities and a fully restored pier where ships will dock upon returning from sea trials.

Valuation

Huntington Ingalls' shares are down 38.7% in the year to date period and 24.5% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Aerospace sector are down 22.2% and 32.5% in the year to date period, respectively. Over the past year, the Zacks sub-industry is down 29% and the Zacks Aerospace sector witnessed a 33.9% decline.

The S&P 500 index is up 8.1% in the year to date period and 20.9% in the past year.

The stock is currently trading at 11.8X forward 12-month earnings, which compares to 21.2X for the Zacks sub-industry, 21.1X for the Zacks sector and 24X for the S&P 500 index.

Over the past five years, the stock has traded as high as 21.3X and as low as 8X, with a 5-year median of 14.3X. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$163 price target reflects 12.5X 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	11.79	21.15	21.12	24
	5-Year High	21.32	22.54	21.12	24
	5-Year Low	8.02	14.52	14.17	16.06
	5-Year Median	14.27	17.76	17.29	18.9
P/S F12M	Current	0.69	1.3	1.69	3.61
	5-Year High	1.6	1.64	1.69	3.61
	5-Year Low	0.69	0.96	0.92	2.37
	5-Year Median	1.11	1.28	1.18	2.9
EV/EBITDA TTM	Current	8.22	31.84	16.45	13.25
	5-Year High	12.76	32.29	16.81	13.25
	5-Year Low	5.33	8.15	7.39	8.25
	5-Year Median	9.11	11.82	10.62	10.92

As of 08/26/2020

Industry Analysis Zacks Industry Rank: Bottom 11% (224 out of 252)



Top Peers

Company (Ticker)	Rec	Rank
Ardmore Shipping Corporation (ASC)	Neutral	3
Bae Systems PLC (BAESY)	Neutral	3
Euronav NV (EURN)	Neutral	3
General Dynamics Corporation (GD)	Neutral	3
Hexcel Corporation (HXL)	Neutral	4
Leidos Holdings, Inc. (LDOS)	Neutral	3
Lockheed Martin Corporation (LMT)	Neutral	3
Northrop Grumman Corporation (NOC)	Neutral	3

Industry Comparison Industry: Aerospace - Defense				Industry Peers		
	HII	X Industry	S&P 500	GD	LMT	NOC
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	5	-	-	3	3	3
VGM Score	A	-	-	B	A	A
Market Cap	6.23 B	11.35 B	23.69 B	43.17 B	110.54 B	56.92 B
# of Analysts	5	5	14	7	8	7
Dividend Yield	2.68%	0.01%	1.65%	2.92%	2.43%	1.70%
Value Score	A	-	-	B	B	B
Cash/Price	0.10	0.09	0.07	0.05	0.03	0.07
EV/EBITDA	7.93	9.79	13.37	9.35	13.20	16.69
PEG Ratio	0.25	2.37	3.04	2.62	2.37	NA
Price/Book (P/B)	3.71	3.33	3.17	3.11	29.20	5.86
Price/Cash Flow (P/CF)	7.50	10.68	12.78	10.10	15.03	12.38
P/E (F1)	10.16	16.40	21.63	13.59	16.40	15.19
Price/Sales (P/S)	0.70	1.11	2.50	1.12	1.76	1.64
Earnings Yield	9.85%	3.91%	4.44%	7.36%	6.10%	6.58%
Debt/Equity	1.44	0.75	0.75	0.75	3.22	1.61
Cash Flow (\$/share)	20.51	2.73	6.94	14.89	26.30	27.58
Growth Score	B	-	-	B	A	A
Hist. EPS Growth (3-5 yrs)	15.53%	14.85%	10.41%	6.15%	18.30%	23.60%
Proj. EPS Growth (F1/F0)	8.24%	-3.74%	-4.92%	-7.59%	9.87%	5.99%
Curr. Cash Flow Growth	-19.56%	11.64%	5.22%	3.16%	18.08%	2.21%
Hist. Cash Flow Growth (3-5 yrs)	6.79%	7.38%	8.50%	6.36%	9.70%	14.43%
Current Ratio	1.30	1.31	1.34	1.27	1.31	1.35
Debt/Capital	59.08%	42.98%	44.18%	42.98%	76.28%	61.62%
Net Margin	5.92%	5.59%	10.25%	8.47%	10.25%	6.91%
Return on Equity	33.81%	10.92%	14.66%	24.10%	182.05%	40.24%
Sales/Assets	1.19	0.79	0.50	0.76	1.29	0.82
Proj. Sales Growth (F1/F0)	0.16%	0.00%	-1.45%	-2.49%	8.29%	4.87%
Momentum Score	A	-	-	D	D	D
Daily Price Chg	-3.18%	-0.64%	-0.18%	-0.66%	0.15%	-0.46%
1 Week Price Chg	-4.95%	-4.20%	-1.45%	-4.25%	-0.47%	-1.23%
4 Week Price Chg	-12.50%	1.68%	2.10%	0.69%	2.10%	8.29%
12 Week Price Chg	-22.93%	0.45%	3.61%	-3.07%	-1.79%	1.62%
52 Week Price Chg	-24.49%	-13.00%	3.61%	-18.86%	3.80%	-6.18%
20 Day Average Volume	373,173	548,987	1,883,291	1,186,784	939,541	724,801
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.29%
(F1) EPS Est 4 week change	-18.41%	0.00%	0.93%	-0.58%	0.00%	1.65%
(F1) EPS Est 12 week change	-20.03%	0.00%	3.41%	-0.86%	2.01%	1.65%
(Q1) EPS Est Mthly Chg	-8.90%	-1.70%	0.00%	-1.65%	0.00%	-1.74%

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	A
Growth Score	B
Momentum Score	A
VGM Score	A

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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