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Jun 30, 2020

Huntington Ingalls(HII)

$177.41 (As of 06/29/20)

Price Target (6-12 Months): **$188.00**

Long Term: 6-12 Months	**Zacks Recommendation:** (Since: 01/27/20) Prior Recommendation: Outperform	**Neutral**
Short Term: 1-3 Months	**Zacks Rank:** (1-5) Zacks Style Scores: Value: B | Growth: D | Momentum: F	**3-Hold** VGM:C

Summary

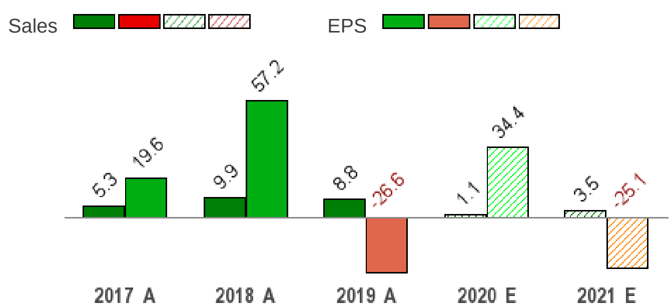
Huntington Ingalls is the sole designer and manufacturer of nuclear-powered aircraft carriers in the United States. The shipbuilding business outlook remains strong, given the proposed fiscal 2021 defense budget, which in turn is benefiting the stock. The company holds a strong liquidity position, which enables it to take important cash deployment decisions. Huntington Ingalls' shares have outperformed the industry in a year. However, competitive pressure is brewing up for future shipbuilding programs that might have a negative impact on the company's profit. 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 have escalated 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)	399,251
Market Cap	$7.2 B
YTD Price Change	-29.3%
Beta	1.11
Dividend / Div Yld	$4.12 / 2.3%
Industry	Aerospace - Defense
Zacks Industry Rank	Bottom 30% (178 out of 253)
Last EPS Surprise	-45.6%
Last Sales Surprise	7.1%
EPS F1 Est- 4 week change	-0.2%
Expected Report Date	08/06/2020
Earnings ESP	0.0%
P/E TTM	13.1
P/E F1	9.4
PEG F1	NA
P/S TTM	0.8

Sales and EPS Growth Rates (Y/Y %)



Sales Estimates (millions of $)

	Q1	Q2	Q3	Q4	Annual*
2021	2,192 E	2,208 E	2,323 E	2,469 E	9,318 E
2020	2,263 A	2,139 E	2,183 E	2,416 E	9,001 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	$5.67 E	$3.35 E	$3.37 E	$3.41 E	$14.11 E
2020	$2.43 A	$4.47 E	$4.16 E	$4.73 E	$18.83 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.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 06/29/2020. The reports text is as of 06/30/2020.

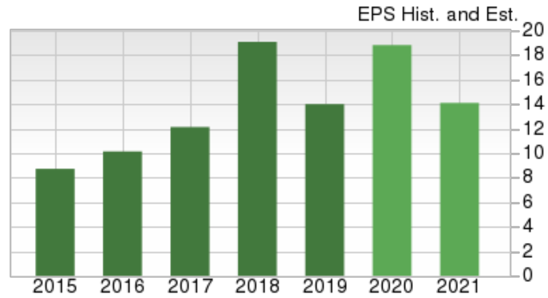
Overview

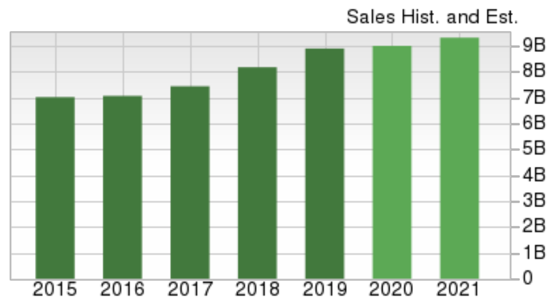
Based in Newport News, VA, **Huntington Ingalls Industries** designs, builds and maintains nuclear-powered ships such as aircraft carriers and submarines, and non-nuclear ships, such as surface combatants, expeditionary warfare/amphibious assault and coastal defense surface ships for the U.S. Navy and 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 $2,555 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, the company's total backlog was $46.5 billion, significantly higher than $23 billion at 2018 end.

Reasons To Buy:

> 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.

▲ **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. Notably, the company ended the first quarter on a solid note, with revenues worth $2.26 billion that reflected a year-over-year improvement of 8.8%. The growth was led by higher sales volume at all three business divisions of the company.

Coming to the quarterly updates, the company's CVN 79 Kennedy is approximately 72% complete and it remains focused on compartment completion and preparation for primary system testing. Its CVN 73 USS George Washington is progressing through its final outfitting and test phase and is approximately 74% complete. On the submarine program, SSN 794 Montana is expected to be launched in the second half of the year and delivered in the first half of 2021. At the Ingalls divisions, the company delivered LHA 7, Tripoli in February 2020. On successful completion, such notable programs should boost the company's top line.

▲ **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 at the end of first-quarter 2019 was approximately $900 million, which resulted in a total backlog of $45 billion as of Mar 31, 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 first quarter 2020 were $28 million. The company's long-term debt as of Mar 31, 2020, stands at $1,820 million, increasing sequentially from $1,450 million. Although the long-term debt level lies much above the company's cash reserve, the company's current ratio as of Mar 31, 2020, is 1.03, which being more than 1, indicates that this defense major has sufficient capital in hand to meet its short-term obligations. The current ratio has also increased sequentially from 0.94. Further, Huntington Ingalls' interest coverage improved sequentially from 10.8 to 11.7 at the end of the first quarter, where as its debt-to-capital ratio of 0.54 also remained below the industry's level of 0.83. These favorable ratios make us optimistic about the company's ability to meet debt obligations in the near future.

Such stable liquidity position enables Huntington Ingalls to take important cash deployment decisions. Evidently, Huntington Ingalls remains on 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 share repurchase program from $2.2 billion to $3.2 billion alongside extending the term of the program to Oct 31, 2024, in November 2019. This reflects Huntington Ingalls' solid cash generating capacity. 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 20.9% compared with the industry's 30.4% decline.

Reasons To Sell:

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

- **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**: Although the pandemic did not have a material impact on Huntington Ingalls' operating results or business in the first quarter of 2020, its ongoing and prolonged impacts might dent its second-quarter performance. This could be because the company is already experiencing issues in each of its business areas related to COVID-19, primarily restricted access to some locations and delay in supplier deliveries. Moreover, the shipbuilder is operating with a reduced level of workforce. The company fears that, continued lower staffing levels and lower employee productivity might impact its ability to achieve anticipated milestones and in turn, affect its 2020 financial results. In fact, as stated in its first quarter earnings call, the company might witness a modest impact of the pandemic on its sales in the second quarter of 2020, due to reduced attendance in shipyard. Since the pandemic is unlikely to die out anytime soon, it might turn out to be a major growth inhibitor for this stock.

Last Earnings Report

Huntington Ingalls Q1 Earnings Miss Estimates, Up Y/Y

Quarter Ending	03/2020
Report Date	May 07, 2020
Sales Surprise	7.12%
EPS Surprise	-45.64%
Quarterly EPS	2.43
Annual EPS (TTM)	13.60

Huntington Ingalls Industries' first-quarter 2020 adjusted earnings of $2.43 per share missed the Zacks Consensus Estimate of $4.47 by 45.6%.

Total Revenues

Total revenues came in at $2.26 billion, exceeding the Zacks Consensus Estimate of $2.11 billion by 7.1%. The top line also rose 8.8% from $2.08 billion in the year-ago quarter. The increase was driven primarily by higher volumes at the Newport News and Ingalls shipbuilding divisions as well as growth in the Technical Solutions division.

Operational Performance

Huntington Ingalls' total operating income grew 33.5% year over year to $215 million, while operating margin was 9.5% compared with 7.7% in the first quarter of 2019. The increases in both metrics mainly resulted from a more favorable operating FAS/CAS adjustment and higher risk retirement at both Newport News and Ingalls shipbuilding divisions.

Huntington Ingalls received orders worth $900 million during the first quarter. As a result, the company's total backlog reached $45.2 billion as of Mar 31.

Segmental Performance

Newport News Shipbuilding: Revenues totaled $1,341 million at this segment, up 4.8% year over year, backed by higher revenues in submarine construction.

Meanwhile, operating income improved 17.3% to $95 million, while operating margin expanded 75 bps to 7.1%. These increases were primarily driven by higher risk retirement on the VCS program and the RCOH of USS George Washington (CVN 73).

Ingalls Shipbuilding: Revenues at this segment increased 7.7% to $629 million on account of higher revenues from the San Antonio-class LPD program and the Arleigh Burke-class DDG program.

Also, operating income surged 47.8% to $68 million, while operating margin expanded 293 bps to 10.8%. These increases were primarily driven by higher risk retirement on the LPD and DDG programs.

Technical Solutions: Revenues at this segment summed $317 million, up 32.1% year over year. The upside was primarily led by higher mission driven innovative solutions (MDIS) revenues attributable to the acquisition of Fulcrum IT Services in 2019 and higher volumes on other MDIS services. The segment incurred an operating loss of $7 million, while operating margin contracted 304 bps during the quarter.

Financial Update

Cash and cash equivalents as of Mar 31, 2020, were $28 million, significantly down from $75 million as of Dec 31, 2019.

Long-term debt, as of Mar 31, 2020, was $1,667 million compared with the 2019-end level of $1,286 million.

Cash from operating activities, at the end of the first quarter of 2020, grossed $68 million compared with $11 million at the end of first-quarter 2019.

Recent News

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 completedby 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.

On **May 5, 2020**, Huntington Ingalls announced that its Ingalls Shipbuilding division has clinched an advance procurement contract worth $187.46 million, from the U.S. Navy, to provide long-lead-time material and advance procurement activities for amphibious assault ship LHA 9.

On **Apr 24, 2020,** Huntington Ingalls' Ingalls Shipbuilding division was awarded a contract modification to exercise the first option year of the existing Littoral Combat Ships (LCS) Planning Yard contract. This option has a potential total value of up to $107.9 million for planning yard services in support of in-service LCS class ships.

Valuation

Huntington Ingalls' shares are down 29.3% in the year to date period and 20.9% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Aerospace sector are down 26.5% and 32.4% in the year to date period, respectively. Over the past year, the Zacks sub-industry is down 30.4% and the Zacks Aerospace sector witnessed a 32.3% decline.

The S&P 500 index is down 6.6% in the year to date period and up 2.1% in the past year.

The stock is currently trading at 10.8X forward 12-month earnings, which compares to 19.8X for the Zacks sub-industry, 19.8X for the Zacks sector and 21.5X 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 $188 price target reflects 11.4X 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	10.76	19.77	19.81	21.54
	5-Year High	21.32	22.54	20.94	22.14
	5-Year Low	8.02	14.52	14.17	15.25
	5-Year Median	14.27	17.67	17.18	17.52
P/S F12M	Current	0.78	1.23	1.09	3.37
	5-Year High	1.6	1.64	1.49	3.44
	5-Year Low	0.69	0.95	0.92	2.53
	5-Year Median	1.11	1.26	1.17	3.02
EV/EBITDA TTM	Current	8.99	18.75	11.2	11.14
	5-Year High	12.76	22.16	15	12.86
	5-Year Low	5.33	8.12	7.39	8.25
	5-Year Median	9.19	11.77	10.53	10.85

As of 06/29/2020

Industry Analysis **Zacks Industry Rank:** Bottom 30% (178 out of 253)

Top Peers

Company (Ticker)	Rec	Rank
Ardmore Shipping Corporation **(ASC)**	Neutral	2
Bae Systems PLC **(BAESY)**	Neutral	3
Euronav NV **(EURN)**	Neutral	3
General Dynamics Corporation **(GD)**	Neutral	3
Leidos Holdings, Inc. **(LDOS)**	Neutral	3
Lockheed Martin Corporation **(LMT)**	Neutral	2
Northrop Grumman Corporation **(NOC)**	Neutral	3
Hexcel Corporation **(HXL)**	Underperform	3

Industry Comparison Industry: Aerospace - Defense

	HII	X Industry	S&P 500	GD	LMT	NOC
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	3	-	-	3	2	3
VGM Score	C	-	-	D	A	D
Market Cap	7.18 B	9.19 B	21.46 B	42.84 B	103.06 B	51.51 B
# of Analysts	4	4	14	8	8	7
Dividend Yield	2.32%	0.86%	1.95%	2.95%	2.61%	1.88%
Value Score	B	-	-	C	B	C
Cash/Price	0.00	0.11	0.07	0.13	0.02	0.07
EV/EBITDA	8.87	10.28	12.54	9.19	12.39	15.59
PEG Ratio	NA	2.35	2.81	2.49	2.21	NA
Price/Book (P/B)	4.40	3.16	2.93	3.25	29.56	5.68
Price/Cash Flow (P/CF)	8.65	10.03	11.53	10.03	13.97	11.20
P/E (F1)	9.31	15.37	20.96	13.41	15.28	13.97
Price/Sales (P/S)	0.79	0.95	2.25	1.10	1.69	1.50
Earnings Yield	10.61%	3.96%	4.53%	7.46%	6.54%	7.16%
Debt/Equity	1.11	0.93	0.76	0.98	3.28	1.72
Cash Flow ($/share)	20.51	2.73	7.01	14.89	26.30	27.58
Growth Score	D	-	-	D	A	D
Hist. EPS Growth (3-5 yrs)	17.40%	12.74%	10.93%	6.71%	17.30%	23.40%
Proj. EPS Growth (F1/F0)	34.39%	1.87%	-10.50%	-7.05%	9.56%	4.28%
Curr. Cash Flow Growth	-19.56%	6.19%	5.51%	3.16%	18.08%	2.21%
Hist. Cash Flow Growth (3-5 yrs)	6.79%	6.62%	8.62%	6.36%	9.70%	14.43%
Current Ratio	1.03	1.32	1.30	1.34	1.23	1.29
Debt/Capital	52.56%	49.52%	44.51%	49.52%	76.64%	63.22%
Net Margin	6.64%	5.89%	10.62%	8.87%	10.21%	6.57%
Return on Equity	34.19%	14.41%	15.82%	25.92%	185.10%	39.22%
Sales/Assets	1.25	0.83	0.55	0.78	1.26	0.83
Proj. Sales Growth (F1/F0)	1.15%	0.00%	-2.61%	-1.48%	6.19%	3.99%
Momentum Score	F	-	-	F	D	C
Daily Price Chg	3.77%	2.78%	1.71%	2.25%	3.01%	2.37%
1 Week Price Chg	-4.31%	-7.25%	-3.90%	-7.34%	-4.15%	-3.45%
4 Week Price Chg	-9.27%	1.28%	-2.17%	1.41%	-5.52%	-6.55%
12 Week Price Chg	-8.41%	9.77%	14.42%	11.71%	-0.12%	-7.01%
52 Week Price Chg	-20.95%	-19.57%	-8.82%	-18.19%	1.67%	-2.99%
20 Day Average Volume	399,251	984,140	2,732,041	1,610,627	1,711,731	1,015,926
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	-0.28%	0.00%	0.00%
(F1) EPS Est 4 week change	-0.25%	0.00%	0.00%	-0.28%	0.00%	0.00%
(F1) EPS Est 12 week change	-15.40%	-12.46%	-10.60%	-9.53%	-0.31%	-3.97%
(Q1) EPS Est Mthly Chg	-5.51%	0.00%	0.00%	-1.12%	0.00%	0.00%

Industry Peers: GD, LMT, NOC

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	D
Momentum Score	F
VGM Score	C

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.

Disclosures

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