

## Northrop Grumman(NOC)

**\$322.56** (As of 05/04/20)

Price Target (6-12 Months): **\$342.00**

Long Term: 6-12 Months

**Zacks Recommendation:**

**Neutral**

(Since: 04/04/19)

Prior Recommendation: Underperform

Short Term: 1-3 Months

**Zacks Rank:** (1-5)

**3-Hold**

Zacks Style Scores:

VGM:F

Value: D

Growth: F

Momentum: D

### Summary

Northrop Grumman posted mixed first-quarter 2020 results. While its earnings missed the ZacksConsensus Estimate, revenues surpassed the same. As a major U.S. defense contractor, Northrop Grumman enjoys a strong position in the Air Force, Space & Cyber Security programs. Its product line is well positioned in high priority categories, which enables it to clinch notable contracts from Pentagon. Northrop has outperformed the industry in the past year. However, it continues to incur high operating expenses due to increase in product costs. Such expenses tend to hurt profit margins. A comparative analysis of its historical EV/Sales ratio reflects a relatively gloomy picture that might be a cause concern for investors. Unforeseen accidents while producing products such as explosive and flammable materials might push up costs.

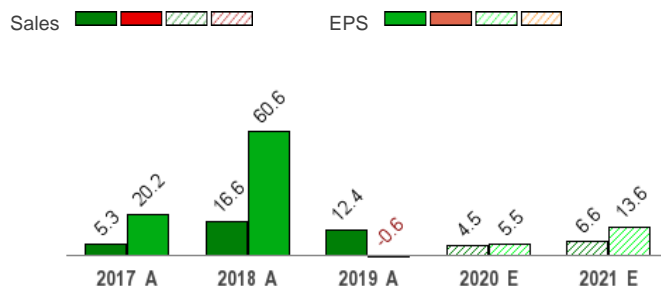
### Price, Consensus & Surprise



### Data Overview

52 Week High-Low	\$385.01 - \$263.31
20 Day Average Volume (sh)	857,996
Market Cap	\$53.8 B
YTD Price Change	-6.2%
Beta	0.81
Dividend / Div Yld	\$5.28 / 1.6%
Industry	<a href="#">Aerospace - Defense</a>
Zacks Industry Rank	Bottom 38% (158 out of 253)

### Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	-5.0%
Last Sales Surprise	1.7%
EPS F1 Est- 4 week change	-3.8%
Expected Report Date	07/22/2020
Earnings ESP	-0.8%
P/E TTM	15.1
P/E F1	14.4
PEG F1	1.1
P/S TTM	1.6

### Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	9,315 E	9,595 E	9,681 E	9,934 E	37,682 E
2020	8,620 A	8,662 E	8,906 E	9,181 E	35,353 E
2019	8,189 A	8,456 A	8,475 A	8,721 A	33,841 A

### EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$6.06 E	\$6.07 E	\$6.45 E	\$6.54 E	\$25.41 E
2020	\$5.15 A	\$5.46 E	\$5.74 E	\$5.95 E	\$22.37 E
2019	\$5.06 A	\$5.06 A	\$5.49 A	\$5.61 A	\$21.21 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 05/04/2020. The reports text is as of 05/05/2020.

## Overview

Originally formed in 1939 as Northrop Aircraft Incorporated and reincorporated in Delaware in 1985 as Northrop Corporation was a principal developer of flying wing technology. In 1994, it acquired Grumman Corporation (Grumman), after which the company was renamed Northrop Grumman Corporation. Currently, this global security company supplies a broad array of products and services to the U.S. Department of Defense (DoD) including electronic systems, information technology, aircraft, space technology and systems integration services. It has realigned its business units effective January 2020.

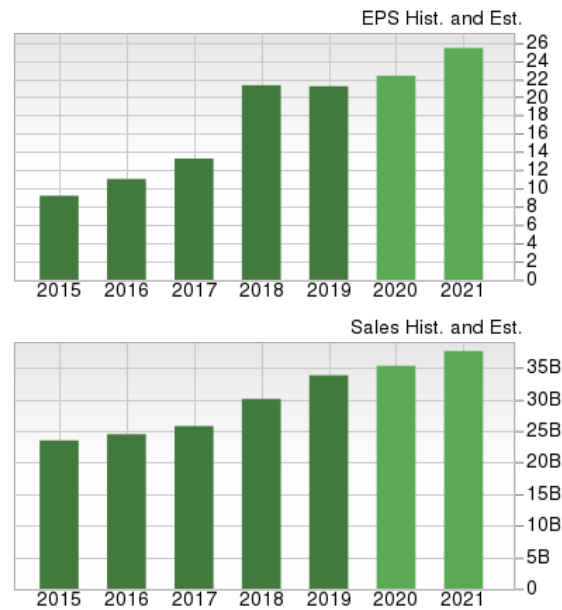
**Aeronautics Systems** focuses on the development, integration, production and support of manned aircraft and autonomous systems. Segmental revenues in first-quarter 2020 totaled \$2,843 million, representing 33% of the company's top line.

**Defense Systems** focuses on mission readiness along with battle management and missile systems. Segmental revenues in first-quarter 2020 totaled \$1,881 million, representing 22% of the company's top line.

**Mission Systems** includes airborne sensors and networks, cyber and intelligence mission solutions, maritime/land systems and sensors, along with navigation, targeting and survivability. Segmental revenues in first-quarter 2020 totaled \$2,347 million, representing 27% of the company's top line.

**Space Systems** focuses on launch and strategic missiles as well as varied space related products that Northrop manufactures. Segmental revenues in first-quarter 2020 totaled \$1,948 million, representing 23% of the company's top line.

However, total revenues of \$8,620 million in the first quarter were adjusted for intersegment eliminations of up to \$399 million.



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## Reasons To Buy:

- ▲ Northrop Grumman has developed into one of the top largest U.S. defense contractors in terms of revenues, with a major platform-centric focus. The company has a strong presence in Air Force, Space & Cyber Security programs. Northrop's product line is well positioned in high priority categories, such as defense electronics, unmanned aircraft and missile defense. Such solid product portfolio enables the company to clinch notable contracts from Pentagon and foreign allies of the United States, thereby boosting its top-line. Notably, Northrop Grumman witnessed solid 5% sales growth in first-quarter 2020 compared with the year-ago quarter's figure, with all four of its business segments delivering encouraging top-line performance.

Northrop Grumman Corporation's gain from favorable budgetary attributes and FMS contracts will help maintain a stable earnings stream. Its financial position also remains strong

- ▲ The fiscal 2021 budget proposal includes \$740.5 billion as funding for the Pentagon, reflecting 3% growth over the approved fiscal 2020 President's budget. In particular, the proposal includes a spending provision worth \$11.4 billion for the F-35 program, for which Northrop Grumman is a subcontractor. The proposal also includes a spending provision worth \$2.8 billion for the company's B-21 Raider long-range strike bomber. Such encouraging spending plans by the U.S. administration are expected to significantly boost growth prospects of defense primes like Northrop Grumman.

Foreign military sales (FMS) are also a key catalyst. The company's international sales came in at \$1.34 billion in the first quarter, comprising 15% of its total sales. Looking ahead, Northrop Grumman continues to witness strong demand for its products on a global scale, with programs like F-35, Triton and SABR radar Global Hawk, E-2D Advanced Hawkeyes, along with a solid set of new programs in the international market. Such strong growth opportunities must have boosted investors' confidence in this stock. Evidently, shares of Northrop Grumman have gained 12.4% in a year, against the industry's 29.6% decline.

- ▲ Northrop Grumman's cash and cash equivalents were \$3.28 billion at the end of first quarter 2020, while its long-term debt was \$15.58 billion as of Mar 31, 2020. The company had \$744 million of outstanding short-term commercial paper borrowings as of Mar 31, 2020. Although the long-term debt value lies much above the company's cash reserve, the current debt is much below its cash balance. This indicates Northrop's strong solvency position, at least in the short term. Additionally, the company has a current ratio of 1.29, as of Mar 31, 2020, compared with 1.13 as of Dec 31, 2019. This improved current ratio indicates this defense major's ability to pay off its short-term obligations.

Further, the company's times interest earned ratio has improved sequentially. It came in at 6 at the end of first-quarter 2020, up from the previous quarter's 5.8. The improvement in this ratio indicates that the firm will be able to meet debt obligations in the near future without any difficulties. Such solid financial position also enables the company to maintain a stable capital deployment strategy. In the first quarter, Northrop made share repurchases worth \$350 million and in April, it bought back shares worth \$130 million. Combining first quarter repurchases with April amounts, the company achieved its target for the year. Considering its payout ratio of 0.25 as of Mar 31, 2020, which improved sequentially from 0.24, we expect it to maintain its solid capital deployment strategy. At a time when every entity is looking forward to preserve liquidity amid uncertainty as a result of the COVID-19 outbreak, improving financial ratios of Northrop Grumman is reassuring for investors.

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## Reasons To Sell:

- ▼ Northrop continues to incur higher operating expenses. Among the different types of operating expenses, rise in product cost has been the highest, probably owing to rapid increase in raw materials price. Total operating costs and expenses at the end of the quarter were \$7,686 million, up 6% from the year-ago quarter, to recover this cost, the company might impose this higher product expenditure on its in terms of higher product price. In a highly competitive environment, customers might get attracted to similar products offered by Northrop's peers at a lower price. Such higher operating expenses tend to put downward pressure on profit margin of a company.
- ▼ A comparative analysis of its historical EV/SALES ratio reflects a relatively gloomy picture that might be a cause for Northrop Grumman's investors' concern. The stock currently has a trailing 12-month EV/SALES ratio of 1.93. This level compares unfavorably with what the stock witnessed in a year's time. Moreover, the company's EV/SALES ratio is higher than that of its sector's ratio of 1.32.
- ▼ Certain of Northrop Grumman's products such as small, medium and large caliber ammunition, solid rocket motors and liquid propulsion engines, involve the using, manufacturing and handling of a variety of explosive as well as flammable materials. Sometimes these activities result in incidents, such as an explosion at the Lake City Army Ammunition Plant in 2017 that caused workplace injuries and fatalities, the temporary shut down or other disruption of manufacturing processes, production delays, environmental harm and expenses, fines and liability to third parties. Although the company has taken initiatives to mitigate such incidents and has insurance coverage, similar or more serious incidents in the future might result in various liabilities and production delays.

Northrop Grumman's increasing operating expenses, unfavorable EV/EBITDA ratio coupled with exposure to workplace related fatalities raise concerns.

## Last Earnings Report

### Northrop Grumman Misses Q1 Earnings, Cuts '20 EPS View

Northrop Grumman reported first-quarter 2020 earnings of \$5.15 per share, which missed the Zacks Consensus Estimate of \$5.42 by 5%. However, the bottom line rose 1.8% from \$5.06 in the year-ago quarter.

#### Total Sales

Northrop Grumman reported total sales of \$8,620 million for the first quarter, surpassing the Zacks Consensus Estimate of \$8,474 million by 1.7%. Moreover, revenues increased 5.3% from the year-ago quarter's \$8,189 million. The year-over-year upside was primarily driven by an 8% increase in Space Systems sales, 6% in Defense Systems sales and 6% in Mission Systems sales.

#### Backlog Count

Northrop Grumman's total backlog stood at \$64.17 billion at the end of first-quarter 2020, compared with \$64.84 billion at 2019-end. Of the total backlog, \$32.52 billion was funded.

#### Segmental Details

Effective Jan 1, 2020, Northrop made some structural changes in its reportable segments. Here are its new segments:

**Aeronautics Systems:** Segment sales of \$2,843 million grew 1% year over year as a result of higher sales from both autonomous systems and manned aircraft.

Operating income declined 16% to \$259 million, whereas operating margin contracted 180 basis points (bps) to 9.1%.

**Mission Systems:** Segment sales increased 6% to \$2,340 million driven by higher sales volume from airborne sensors and networks along with maritime/land systems and sensors programs.

Operating income rose 9% to \$348 million, with operating margin expanding 40 bps to 14.8%.

**Defense Systems:** Sales at this segment improved 6% to \$1,881 million due to higher sales of battle management and missile systems as well as mission readiness.

Operating income declined 3% to \$196 million, with operating margin contracting 10 bps to 10.4%.

**Space Systems:** Space Systems' first-quarter 2020 sales increased 8% to \$1,948 million owing to higher sales from the Space program.

The segment's operating income improved 6% to \$199 million while operating margin contracted 20 bps to 10.2%.

#### Operational Update

Total operating costs and expenses at the end of the quarter were \$7,686 million, up 6%.

Operating income during the quarter slipped 0.2% to \$934 million.

#### Financial Condition

Northrop Grumman's cash and cash equivalents, as of Mar 31, 2020, were \$3,278 million, up from \$2,245 million, as of Dec 31, 2019.

Long-term debt (net of current portion), as of Mar 31, 2020, was \$14,299 million, up from \$12,770 million, as of 2019-end.

Net cash outflow from operating activities, as of Mar 31, 2020, was \$993 million compared with \$913 million, as of Mar 31, 2019.

#### 2020 Guidance

Considering the global impact of the COVID-19 pandemic, Northrop Grumman has lowered its 2020 revenue and earnings guidance. The company currently expects to generate revenues in the range of \$35.0-\$35.4 billion, compared with its prior guidance range of \$35.3-\$35.8 billion during 2020. The Zacks Consensus Estimate of \$35.63 billion is higher than the midpoint of the company provided guidance range.

The company's 2020 earnings are currently expected to be in the range of \$21.80-\$22.20 per share, compared with the previous band of \$22.75-\$23.15 per share. The Zacks Consensus Estimate of \$22.97 is higher than the company provided guidance range.

The company however, continues to expect free cash flow of \$3.15-\$3.45 billion in 2020.

Quarter Ending 03/2020

Report Date	Apr 29, 2020
Sales Surprise	1.72%
EPS Surprise	-4.98%
Quarterly EPS	5.15
Annual EPS (TTM)	21.31

## Recent News

On **Apr 1, 2020**, Northrop Grumman's business unit, Aerospace Systems, won a modification contract to offer non-recurring engineering and software support activities as well as product support for E-2D Advanced Hawkeye (AHE) full rate production (FRP). Work related to the deal is expected to be completed by March 2025.

Valued at \$404 million, the contract was awarded by the Naval Air Systems Command, Patuxent River, MD. Per the terms of the contract, the company will procure two E-2D AHE aircraft, one each in FRP of the 8th and 9th lots.

The majority of the task will be carried out in St. Augustine, FL; Liverpool, NY and Melbourne, FL.

On **Feb 28, 2020**, Northrop Grumman announced that it received a \$110 million production order from the U.S. Air Force late last year for FMU-167/B, also known as the Hard Target Void Sensing Fuze.

On **Feb 3, 2020**, Northrop Grumman announced the integration of  $\mu$ SASTM onto L3Harris Technologies' Iver4 Unmanned Undersea Vehicle (UUV) for a 12-month test period for the Defense Innovation Unit's (DIU) Next Generation Small-Class UUV program.

On **Jan 22, 2020**, Northrop Grumman Corp.'s subsidiary, Northrop Grumman Systems Corp., secured a modification contract valued at \$217.2 million for supporting Battle Field Airborne Communication Node (BACN) payload operation, equipment and services. The contract was awarded by the Air Force Life Cycle Management Center's Space, Hanscom Air Force Base, MA. Work related to the deal will be executed in San Diego, CA, along with other overseas locations and is expected to get completed by Jan 23, 2021.

## Valuation

Northrop Grumman's shares are down 5.8% in the year to date period, although up 12.4% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Aerospace sector are down 28.8% and 35.1% in the year to date period, respectively. Over the past year, the Zacks sub-industry and sector are down 30.6% and 32.9%, respectively.

The S&P 500 index is down 11.5% in the year to date period and 1.3% in the past year.

The stock is currently trading at 13.8X forward 12-month earnings, which compares to 19.4X for the Zacks sub-industry, 18.4X for the Zacks sector and 20.2X for the S&P 500 index.

Over the past five years, the stock has traded as high as 25.4X and as low as 11.4X, with a 5-year median of 18X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$342 price target reflects 14.6X forward 12-month earnings.

The table below shows summary valuation data for NOC

Valuation Multiples - NOC					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	13.78	19.35	18.43	20.18
	5-Year High	25.37	22.54	20.94	20.18
	5-Year Low	11.35	14.52	14.17	15.19
	5-Year Median	17.93	17.19	17.06	17.44
P/S F12M	Current	1.49	1.19	1.1	3.19
	5-Year High	2.23	1.64	1.49	3.44
	5-Year Low	1.16	0.95	0.92	2.54
	5-Year Median	1.62	1.27	1.18	3.01
EV/EBITDA TTM	Current	10.31	13.38	10.32	10.66
	5-Year High	23.35	19.49	14.99	12.87
	5-Year Low	9	8.12	7.39	8.27
	5-Year Median	13.12	11.7	10.42	10.78

As of 05/04/2020

## Industry Analysis Zacks Industry Rank: Bottom 38% (158 out of 253)



## Top Peers

Company (Ticker)	Rec	Rank
The Boeing Company (BA)	Neutral	3
Bae Systems PLC (BAESY)	Neutral	3
General Dynamics Corporation (GD)	Neutral	3
Heico Corporation (HEI)	Neutral	4
Huntington Ingalls Industries, Inc. (HII)	Neutral	3
Leidos Holdings, Inc. (LDOS)	Neutral	2
Lockheed Martin Corporation (LMT)	Neutral	3
Textron Inc. (TXT)	Underperform	5

Industry Comparison Industry: Aerospace - Defense				Industry Peers		
	NOC	X Industry	S&P 500	BA	GD	LMT
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	3	-	-	3	3	3
VGM Score	F	-	-	F	D	B
Market Cap	53.77 B	7.33 B	19.65 B	74.19 B	35.79 B	106.61 B
# of Analysts	6	4.5	14	6	7	7
Dividend Yield	1.64%	0.84%	2.19%	0.00%	3.53%	2.53%
Value Score	D	-	-	D	C	C
Cash/Price	0.06	0.12	0.06	0.21	0.15	0.02
EV/EBITDA	16.14	8.31	11.76	116.10	7.91	12.78
PEG Ratio	1.12	2.17	2.48	NA	2.06	2.28
Price/Book (P/B)	5.93	2.65	2.63	NA	2.71	30.57
Price/Cash Flow (P/CF)	11.69	8.77	10.38	242.81	8.38	14.45
P/E (F1)	14.42	15.81	18.81	NA	11.09	15.81
Price/Sales (P/S)	1.57	0.87	2.02	1.05	0.92	1.74
Earnings Yield	6.94%	5.55%	5.07%	-3.41%	9.02%	6.32%
Debt/Equity	1.72	0.82	0.73	-3.61	0.98	3.28
Cash Flow (\$/share)	27.58	2.73	7.01	0.54	14.89	26.30
Growth Score	F	-	-	F	F	A
Hist. EPS Growth (3-5 yrs)	23.40%	11.79%	10.87%	-6.39%	6.71%	17.30%
Proj. EPS Growth (F1/F0)	5.45%	8.65%	-8.14%	-29.11%	-6.09%	9.52%
Curr. Cash Flow Growth	2.21%	6.19%	5.88%	-97.35%	3.16%	18.08%
Hist. Cash Flow Growth (3-5 yrs)	14.43%	6.62%	8.55%	-48.30%	6.36%	9.70%
Current Ratio	1.29	1.26	1.25	1.17	1.34	1.23
Debt/Capital	63.22%	47.20%	44.07%	NA	49.52%	76.64%
Net Margin	6.57%	6.09%	11.00%	-4.84%	8.87%	10.21%
Return on Equity	39.22%	17.71%	16.43%	-3.08%	25.92%	185.10%
Sales/Assets	0.83	0.83	0.55	0.53	0.78	1.26
Proj. Sales Growth (F1/F0)	4.47%	0.00%	-1.76%	-11.95%	-1.42%	6.30%
Momentum Score	D	-	-	F	D	C
Daily Price Chg	-1.68%	-2.29%	-0.01%	-1.43%	-2.36%	-0.86%
1 Week Price Chg	-3.32%	-0.19%	0.53%	3.40%	-1.16%	0.45%
4 Week Price Chg	-2.94%	-4.48%	6.66%	-11.64%	-6.66%	3.32%
12 Week Price Chg	-11.21%	-31.50%	-20.38%	-61.86%	-33.00%	-13.55%
52 Week Price Chg	10.72%	-31.33%	-13.44%	-64.62%	-28.84%	13.24%
20 Day Average Volume	857,996	957,971	2,567,149	35,696,664	2,025,278	1,358,737
(F1) EPS Est 1 week change	-3.55%	0.00%	0.00%	-31.38%	-4.66%	0.36%
(F1) EPS Est 4 week change	-3.83%	-1.62%	-6.96%	-283.56%	-9.06%	-0.34%
(F1) EPS Est 12 week change	-3.99%	-11.52%	-13.90%	-190.25%	-11.52%	-0.34%
(Q1) EPS Est Mthly Chg	-4.98%	-4.98%	-13.62%	-31.54%	-18.55%	-1.92%

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## 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.

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### 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	D
Growth Score	F
Momentum Score	D
VGM Score	F

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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