

## Northrop Grumman(NOC)

**\$375.01** (As of 01/03/20)

Price Target (6-12 Months): **\$398.00**

Long Term: 6-12 Months

**Zacks Recommendation:**

**Neutral**

(Since: 04/04/19)

Prior Recommendation: Underperform

Short Term: 1-3 Months

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

**2-Buy**

Zacks Style Scores:

VGM:B

Value: C

Growth: B

Momentum: B

### Summary

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 also well positioned in high priority categories, such as defense electronics, unmanned aircraft and missile defense, which enables the company to clinch notable contracts from Pentagon and foreign allies. Northrop Grumman outperformed the industry in the past year. However, it continues to incur high operating expenses on account of increasing 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 for its investor's concern. Unforeseen accidents while production of certain of Northrop Grumman's products such as explosive and flammable materials, tend to push up its costs.

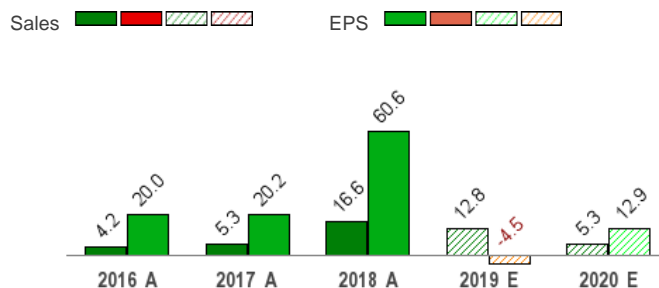
### Price, Consensus & Surprise



### Data Overview

52 Week High-Low	\$383.89 - \$242.52
20 Day Average Volume (sh)	760,707
Market Cap	\$63.2 B
YTD Price Change	9.0%
Beta	0.76
Dividend / Div Yld	\$5.28 / 1.4%
Industry	<a href="#">Aerospace - Defense</a>
Zacks Industry Rank	Top 12% (31 out of 252)

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



Last EPS Surprise	15.8%
Last Sales Surprise	-0.8%
EPS F1 Est- 4 week change	0.4%
Expected Report Date	01/30/2020
Earnings ESP	-0.5%
P/E TTM	18.3
P/E F1	16.3
PEG F1	1.3
P/S TTM	1.9

### Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2020	8,522 E	8,836 E	8,887 E	9,232 E	35,775 E
2019	8,189 A	8,456 A	8,475 A	8,828 E	33,960 E
2018	6,735 A	7,119 A	8,085 A	8,156 A	30,095 A

### EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2020	\$5.43 E	\$5.59 E	\$5.68 E	\$5.85 E	\$23.01 E
2019	\$5.06 A	\$5.06 A	\$5.49 A	\$4.78 E	\$20.38 E
2018	\$4.21 A	\$3.93 A	\$6.54 A	\$4.93 A	\$21.33 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 01/03/2020. The reports text is as of 01/06/2020.

## 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. Its existing business units are:

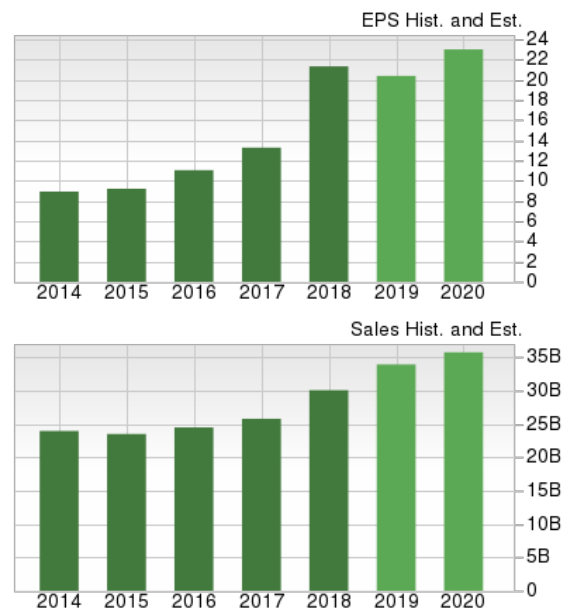
**Aerospace Systems** focuses on the development, integration, production and support of manned and unmanned aircraft, spacecraft, high-energy laser systems, and microelectronics. Segmental revenues in 2018 totaled \$13,096 million, representing 43.5% of the company's top line.

**Mission Systems** focuses on the development of new capabilities for the company's military and intelligence customers. It provides advanced end-to-end mission solutions and multifunction systems for the U.S. Department of Defense (DoD), national intelligence, and international, federal civil, state and commercial customers. Segmental revenues in 2018 totaled \$11,709 million, representing 38.9% of the company's top line.

**Technology Services** offers innovative, technology driven solutions and services to enable cost-effective improvements for customer mission effectiveness. Segmental revenues in 2018 totaled \$4,297 million, representing 14.3% of the company's top line.

**Innovation Systems** was formed post the acquisition of Orbital ATK. Products in this unit include launch vehicles and related propulsion systems; missile products, subsystems and defense electronics; precision weapons, armament systems and ammunition; satellites and associated space components and services; and advanced aerospace structures. Segmental revenues in 2018 totaled \$3,276 million, representing 10.9% of the company's top line.

However, total revenues of \$30,095 million in 2018, were adjusted for intersegment eliminations up to \$2,283 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 4.8% sales growth in the third quarter of 2019 compared with the year-ago quarter's figure.
- ▲ The fiscal 2020 budget includes \$718.3 billion as funding for the Pentagon, reflecting 5% real growth over the approved fiscal 2019 President's budget. In particular, the proposal includes a spending provision worth \$11.2 billion for the F-35 program, for which Northrop Grumman is a subcontractor. Such notable spending plans by the U.S. administration are expected to significantly boost defense primes like Northrop Grumman, going ahead.
- ▲ Defense being a capital-intensive sector, investing in the business remains Northrop Grumman's first priority. In 2018, the company made capital investments worth \$1,249 million, up 34.6% annually. Per management, the company's capital spending reflects increased programmatic requirements and supports its continued focus on cost reduction, affordability and investments to support the company's long-term growth strategy. In September, the company also announced the realignment of its business segments, beginning January 2020. This strategy is expected to enable the company to quickly identify and deliver solutions for rapidly evolving national security challenges. The realignment is further aimed at driving continued strong execution, sustained profitable growth and operational efficiency.
- ▲ Foreign military sales (FMS) continues to act as a key catalyst for Northrop Grumman. The company's international sales came in at \$1.2 billion, comprising 14% of its total sales in the third quarter. Moreover, international sales registered 9.6% year-over-year growth in the reported quarter. 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. These growing set of international opportunities are expected to boost the company's margin growth. Such strong international growth opportunities must have boosted investors' confidence in this stock. Evidently, shares of Northrop Grumman have gained 52.5% in a year, outperforming its industry's 25.6% growth.

Northrop Grumman Corporation's gain from acquisition of Orbital, favorable budgetary attributes and FMS contracts will help maintain a stable earnings stream.

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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 third quarter amounted to \$7,524 million, up 8.8% from the year-ago quarter. Its product costs also rose 12.9% to \$4,777 million from the prior-year quarter. Evidently, 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 2.32. 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 1.78.
- ▼ 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 for it.

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

## Last Earnings Report

### Northrop Grumman Q3 Earnings Beat, Ups '19 EPS View

Northrop Grumman Corporation reported third-quarter 2019 earnings of \$5.49 per share, which surpassed the Zacks Consensus Estimate of \$4.74 by 15.8%. However, the bottom line declined 22.8% from \$7.11 per share, reported in the year-ago quarter.

#### Total Sales

In third-quarter 2019, Northrop Grumman reported total sales of \$8,475 million, which missed the Zacks Consensus Estimate of \$8,546 million by 0.83%. However, sales increased 4.8% from the year-ago quarter's \$8,085 million. The upside was driven by the increase in all of the company's business segments.

#### Backlog

Northrop Grumman's total backlog at the end of third-quarter 2019 was \$65 billion. Funded backlog during the third quarter amounted to \$31.96 billion, whereas unfunded backlog during the quarter amounted to \$33.04 billion.

#### Segmental Details

**Aerospace Systems:** Sales at this segment totaled \$3,458 million, up 5% year over year. This improvement was backed by increased sales due to higher volumes of Manned Aircraft, Autonomous Systems and Space programs.

Operating income declined 14% to \$324 million, while operating margin contracted 210 basis points (bps) to 9.4%.

**Mission Systems:** Segment sales increased 4% to \$3,029 million on higher sales in Cyber and ISR, Advanced Capabilities, and Sensors and Processing business areas.

Operating income declined 0.3% to \$398 million while operating margin contracted 60 bps to 13.1%.

**Technology Services:** Sales at this segment rose 3% to \$1,067 million, due to high Global Logistics and Modernization sales.

Operating income increased 23% to \$136 million, with operating margin expansion of 200 bps to 12.7%.

**Innovation Systems:** Third-quarter 2019 sales in this segment increased 12% to \$1,584 million compared with sales of \$1,415 million in the third quarter of 2018. The increase was principally due to higher sales at Space Systems, Flight Systems and Defense Systems.

Meanwhile, the segment's operating income totaled \$164 million and operating margin contracted 100 bps to 10.4%.

#### Operational Update

Total operating costs and expenses at the end of the quarter were \$7,524 million, up 8.8% from the year-ago quarter's \$6,913 million.

Operating income during the quarter declined 18.9% year over year to \$951 million.

#### Financial Condition

Northrop Grumman's cash and cash equivalents as of Sep 30, 2019, were \$1,127 million, down from \$1,579 million as of Dec 31, 2018.

Long-term debt (net of current portion) as of Sep 30, 2019, was \$13,826 million, down from \$13,883 million as of Dec 31, 2018.

Net cash inflow from operating activities as of Sep 30, 2019, was \$1,833 million compared with \$1,450 million as of Sep 30, 2018.

#### 2019 Guidance

Northrop Grumman expects to generate revenues of \$34 billion during 2019. The Zacks Consensus Estimate for the company's full-year sales, pegged at \$33.99 billion, lies slightly below its projected view.

It expects to project free cash flow of \$2.7-\$3 billion for 2019.

However, Northrop Grumman raised its full-year earnings expectations from \$19.30-\$19.55 to \$20.10-\$20.35 per share. The Zacks Consensus Estimate for the company's 2019 earnings, pegged at \$19.63, lies below the company's guidance.

Quarter Ending **09/2019**

Report Date	Oct 24, 2019
Sales Surprise	-0.83%
EPS Surprise	15.82%
Quarterly EPS	5.49
Annual EPS (TTM)	20.54

## Recent News

On **Dec 24, 2019**, Northrop Grumman Corp.'s business unit, Northrop Grumman Systems Corp. secured a contract to provide ground stations, trade studies, tooling and associated support equipment in relation to production of MQ-4C Triton unmanned aircraft. The deal has been awarded by the Naval Air Systems Command, Patuxent River, MD.

Valued at \$251.6 million, the contract is scheduled to be completed by February 2023. The majority of the work related to the deal will be carried out in San Diego and Palmdale, CA as well as Red Oak, TX.

On **Dec 20, 2019**, Northrop Grumman Corp.'s business subsidiary, Northrop Grumman Systems Corp., secured a \$1-billion contract for the production of Active Electronically Scanned Array (AESA) radars. These radars will be installed in the Air Force's F-16 aircraft, developed by Lockheed Martin (LMT - Research Report). The modification contract was awarded by the Air Force Life Cycle Management Center, Fighter Bomber Directorate, F-16 Division, Wright Patterson Air Force Base, OH.

Per the deal terms, Northrop Grumman Systems Corp will definitize all three phases of the program to include development and production of up to 372 AESA radars. Work related to the deal will be performed at Linthicum Heights, MD, and is expected to get completed by May 2027.

On **Nov 7, 2019**, Northrop Grumman announced that has delivered its 500th AN/APG-81 fire control radar for the F-35 Lightning II. The Northrop Grumman AN/APG-81 active electronically scanned array is the cornerstone of the F-35's advanced sensor suite, providing unparalleled battlespace situational awareness that translates into platform lethality, effectiveness and survivability.

On **Sep 26, 2019**, Northrop Grumman Corp.'s business division, Northrop Grumman Systems, clinched a modification contract for the production and delivery of nine E-2D Advanced Hawkeye aircraft to Japan. The deal has been awarded by the Naval Air Systems Command, Patuxent River, Maryland.

Valued at \$1.36 billion, this contract entails Foreign Military Sales (FMS). Work related to the agreement will be carried out in various locations inside and outside the continental United States including Augustine and Melbourne, FL; Syracuse, NY; El Segundo, CA, and a few more.

On **Sep 16, 2019**, Northrop Grumman Corp.'s business subsidiary, Northrop Grumman Systems Corp., recently secured a contract worth \$57.4-million for the production of Joint Counter Radio-Controlled Improvised Explosive Device Electronic Warfare (JCREW) systems. The contract was awarded by Naval Sea Systems Command, Washington, CA.

## Valuation

Northrop Grumman's shares are up 16.6% in the past six months, and up 52.5% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Aerospace sector are up 4.4% and 7.7% in the past six months, respectively. Over the past year, the Zacks sub-industry and sector are up 25.6% and 32%, respectively.

The S&P 500 index is up 10.4% in the past six months period and 28.5% in the past year.

The stock is currently trading at 16.26X forward 12-month earnings, which compares to 16.76X for the Zacks sub-industry, 17.08X for the Zacks sector and 18.71X for the S&P 500 index.

Over the past five years, the stock has traded as high as 25.37X and as low as 12.26X, with a 5-year median of 17.94X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$398 price target reflects 17.26X 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	16.26	16.76	17.08	18.71
	5-Year High	25.37	22.53	21.56	19.34
	5-Year Low	12.26	14.53	14.28	15.17
	5-Year Median	17.94	16.94	16.83	17.44
P/S F12M	Current	1.77	1.44	1.25	3.47
	5-Year High	2.23	1.59	1.37	3.47
	5-Year Low	1.16	0.92	0.79	2.54
	5-Year Median	1.61	1.21	1.05	3
EV/EBITDA TTM	Current	14.64	13.8	12.65	11.99
	5-Year High	23.33	14.63	13.08	12.86
	5-Year Low	9.45	8.07	7.18	8.48
	5-Year Median	13.14	11.21	9.78	10.67

As of 01/03/2020

## Industry Analysis Zacks Industry Rank: Top 12% (31 out of 252)



## Top Peers

Heico Corporation (HEI)	Outperform
Huntington Ingalls Industries, Inc. (HII)	Outperform
Leidos Holdings, Inc. (LDOS)	Outperform
Bae Systems PLC (BAESY)	Neutral
General Dynamics Corporation (GD)	Neutral
Lockheed Martin Corporation (LMT)	Neutral
Raytheon Company (RTN)	Neutral
The Boeing Company (BA)	Underperform

Industry Comparison Industry: Aerospace - Defense				Industry Peers		
	NOC Neutral	X Industry	S&P 500	BA Underperform	GD Neutral	LMT Neutral
<b>VGM Score</b>	<b>B</b>	-	-	<b>D</b>	<b>B</b>	<b>B</b>
Market Cap	63.20 B	10.78 B	23.66 B	187.27 B	52.13 B	116.70 B
# of Analysts	7	5	13	6	9	9
Dividend Yield	1.41%	0.87%	1.79%	2.47%	2.26%	2.32%
<b>Value Score</b>	<b>C</b>	-	-	<b>C</b>	<b>B</b>	<b>C</b>
Cash/Price	0.02	0.03	0.04	0.06	0.02	0.02
EV/EBITDA	15.13	14.73	13.88	13.79	11.56	16.54
PEG Ratio	1.27	2.35	1.99	2.44	1.62	2.41
Price/Book (P/B)	6.49	4.33	3.36	NA	3.86	29.64
Price/Cash Flow (P/CF)	14.07	16.44	13.62	16.44	12.42	18.61
P/E (F1)	16.30	17.99	18.74	19.90	13.95	17.05
Price/Sales (P/S)	1.90	1.31	2.67	2.15	1.34	2.00
Earnings Yield	6.14%	5.48%	5.32%	5.03%	7.17%	5.86%
Debt/Equity	1.55	0.77	0.72	-5.33	0.67	3.21
Cash Flow (\$/share)	26.65	3.73	6.94	20.24	14.51	22.24
<b>Growth Score</b>	<b>B</b>	-	-	<b>F</b>	<b>C</b>	<b>A</b>
Hist. EPS Growth (3-5 yrs)	22.40%	10.80%	10.56%	19.64%	7.41%	14.78%
Proj. EPS Growth (F1/F0)	12.87%	13.55%	7.41%	1,676.10%	8.38%	12.19%
Curr. Cash Flow Growth	61.17%	18.22%	14.83%	22.32%	20.42%	24.70%
Hist. Cash Flow Growth (3-5 yrs)	14.12%	7.64%	9.00%	9.55%	6.79%	6.70%
Current Ratio	1.29	1.22	1.23	1.11	1.11	1.28
Debt/Capital	60.86%	46.46%	42.92%	NA	39.95%	76.27%
Net Margin	9.05%	6.36%	11.08%	4.37%	8.66%	10.26%
Return on Equity	39.12%	16.88%	17.10%	-367.68%	26.79%	221.59%
Sales/Assets	0.84	0.92	0.55	0.70	0.82	1.23
Proj. Sales Growth (F1/F0)	5.34%	5.34%	4.20%	35.31%	4.54%	5.31%
<b>Momentum Score</b>	<b>B</b>	-	-	<b>F</b>	<b>B</b>	<b>C</b>
Daily Price Chg	5.43%	0.43%	-0.61%	-0.17%	0.98%	3.60%
1 Week Price Chg	0.15%	0.33%	0.13%	0.65%	-0.47%	1.84%
4 Week Price Chg	8.88%	5.29%	2.60%	-3.74%	-1.20%	7.20%
12 Week Price Chg	1.70%	9.59%	8.87%	-10.31%	1.98%	6.94%
52 Week Price Chg	56.31%	39.54%	29.34%	7.03%	17.48%	60.32%
20 Day Average Volume	760,707	458,085	1,603,615	5,753,429	994,325	784,596
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	0.39%	0.00%	0.00%	-14.60%	-0.07%	0.00%
(F1) EPS Est 12 week change	2.69%	-0.25%	-0.57%	-21.55%	-1.48%	-3.74%
(Q1) EPS Est Mthly Chg	0.00%	0.00%	0.00%	-11.29%	0.00%	0.00%

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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	C
Growth Score	B
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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