

Northrop Grumman(NOC)

\$336.65 (As of 04/09/20)

Price Target (6-12 Months): **\$357.00**

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:A

Value: C

Growth: A

Momentum: A

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 well positioned in high priority categories, which enables it to clinch notable contracts from Pentagon and foreign allies. Its capital spending supports its continued focus on cost reduction and investments to support the company's long-term growth strategy. Northrop 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 concern for investors. Unforeseen accidents while producing products such as explosive and flammable materials pushes up costs.

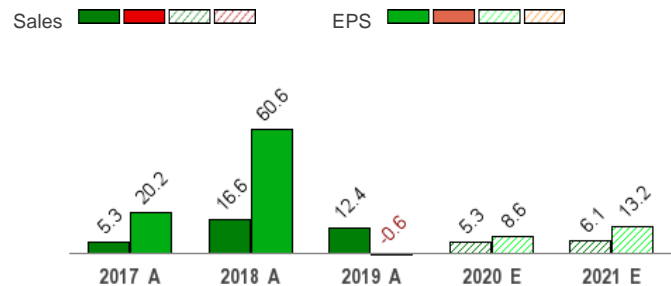
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$385.01 - \$263.31
20 Day Average Volume (sh)	1,472,365
Market Cap	\$56.3 B
YTD Price Change	-2.1%
Beta	0.83
Dividend / Div Yld	\$5.28 / 1.6%
Industry	Aerospace - Defense
Zacks Industry Rank	Top 32% (82 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	17.4%
Last Sales Surprise	-1.2%
EPS F1 Est- 4 week change	-0.1%
Expected Report Date	04/29/2020
Earnings ESP	2.5%
P/E TTM	15.9
P/E F1	14.6
PEG F1	1.1
P/S TTM	1.7

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	9,263 E	9,613 E	9,698 E	9,951 E	37,814 E
2020	8,474 E	8,880 E	8,985 E	9,272 E	35,631 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	\$5.92 E	\$6.24 E	\$6.56 E	\$6.78 E	\$26.08 E
2020	\$5.37 E	\$5.74 E	\$5.86 E	\$6.07 E	\$23.03 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 04/09/2020. The reports text is as of 04/13/2020.

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:

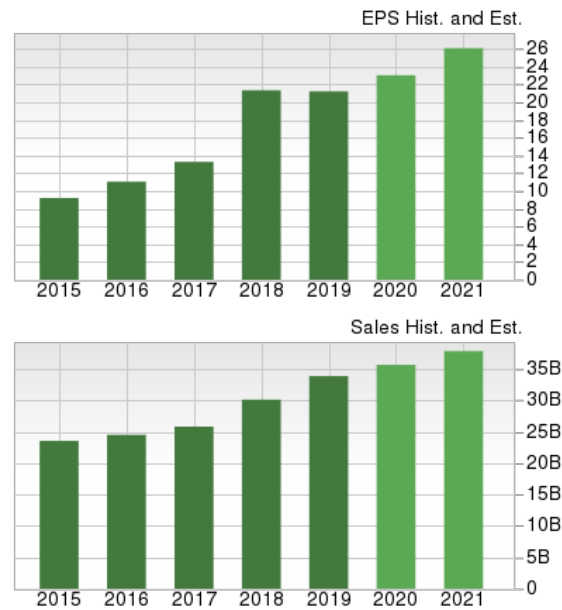
Aerospace Systems focuses on the development, integration, production and support of manned and unmanned aircraft, spacecraft, high-energy laser systems, and microelectronics. Segmental revenues in 2019 totaled \$13,862 million, representing 41% of the company's top line.

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 2019 totaled \$12,263 million, representing 36.2% 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 2019 totaled \$4,110 million, representing 12.1% 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 2019 totaled \$6,119 million, representing 18.1% of the company's top line.

However, total revenues of \$33,841 million in 2019, were adjusted for intersegment eliminations up to \$2,513 million.



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 12% sales growth in fourth-quarter 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 2019, the company made capital investments worth \$1,264 million, up 1.2% annually. Per management, the company's capital spending supports its continued focus on cost reduction, affordability and investments to support the company's long-term growth strategy. Meanwhile in September, the company 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 \$5.15 billion in 2019, 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. 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 20.2% in a year, against the industry's 26.6% decline.

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

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 \$29,872 million, up 13.6% from the year-ago quarter. Its product costs also rose 18.3% to \$18,675 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 2.02. 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 1.36.
- ▼ 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 Tops Q4 Earnings, Revenues Down Y/Y

Northrop Grumman Corporation reported fourth-quarter 2019 earnings of \$5.61 per share, beating the Zacks Consensus Estimate of \$4.78 by 17.4%. Reported earnings also improved 13.8% from \$4.93 recorded in the year-ago quarter.

For 2019, earnings were \$21.21 per share, down 0.56% from the year-ago quarter. Moreover, full-year earnings figure exceeded the Zacks Consensus Estimate of \$20.39 by 4%.

Quarter Ending **12/2019**

Report Date	Jan 30, 2020
Sales Surprise	-1.21%
EPS Surprise	17.36%
Quarterly EPS	5.61
Annual EPS (TTM)	21.22

Total Revenues

In fourth-quarter 2019, Northrop Grumman reported total revenues of \$8,721 million, missing the Zacks Consensus Estimate of \$8,828 million by 1.2%. However, revenues increased 6.9% from the year-ago quarter's \$8,156 million. The year-over-year revenue upside was primarily driven by 10% increase in Aerospace systems sales, 9% in Innovation Systems sales, and 6% in Mission Systems sales.

In 2019, total revenues increased 12.4% year over year to \$33,841 million. Full-year revenues however missed the Zacks Consensus Estimate of \$33,960 million, by a mere 0.35%.

Segmental Details

Aerospace Systems: Segment sales of \$3,518 million increased 10% year over year as a result of higher volumes of manned aircraft, autonomous systems and space programs.

Operating income rose 9% to \$367 million, whereas operating margin contracted 10 basis points (bps) to 10.5%.

Mission Systems: Segment sales increased 6% to \$3,220 million, due to higher sales volume of Advanced Capabilities, Cyber and ISR and Sensors and Processing systems.

Operating income rose 13% to \$450 million, with operating margin expanding 90 bps to 14%.

Technology Services: Sales at this segment dropped 4% to \$1,022 million, primarily due to the low Global Logistics and Modernization sales.

Operating income declined 8% to \$106 million, with operating margin contracted 40 bps to 10.4%.

Innovation Systems: Innovation Systems' fourth-quarter 2019 proforma sales increased 9% to \$1,599 million compared with \$1,461 million proforma sales in the fourth-quarter of 2018. The sales increase was due to higher volume for Space Systems, Flight Systems and Defense Systems.

The segments' operating income totaled \$171 million and operating margin rate expanded 90 bps to 10.7%.

Operational Update

Total operating costs and expenses at the end of the quarter were \$29,872 million, up 13.6%.

Operating income during the quarter increased 5% to \$3,969 million.

Financial Condition

Northrop Grumman's cash and cash equivalents as of Dec 31, 2019 were \$2,245 million, down from \$1,579 million as of Dec 31, 2018.

Long-term debt (net of current portion) as of Dec 31, 2019, was \$12,770 million, down from \$13,883 million as of 2018 end.

Net cash inflow from operating activities as of Dec 31, 2019 was \$4,297 million compared with \$3,827 million as of Dec 31, 2018.

2020 Guidance

Northrop Grumman currently expects to generate revenues of \$35.3-\$35.8 billion during 2020. The company expects free cash flow of \$3.15-\$3.45 billion in 2019. The 2020 earnings are expected to be \$22.75-\$23.15 per share.

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 μ 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 2.2% in the year to date period, although up 20.2% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Aerospace sector are down 25.5% and 32.1% in the year to date period, respectively. Over the past year, the Zacks sub-industry and sector are down 26.6% and 29.1%, respectively.

The S&P 500 index is down 13.4% in the year to date period and down 4.3% in the past year.

The stock is currently trading at 14X forward 12-month earnings, which compares to 17.9X for the Zacks sub-industry, 17.3X for the Zacks sector and 15.2X for the S&P 500 index.

Over the past five years, the stock has traded as high as 25.4X and as low as 11.9X, with a 5-year median of 18X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$357 price target reflects 14.9X 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	14.04	17.93	17.27	15.16
	5-Year High	25.37	22.54	20.94	19.34
	5-Year Low	11.91	14.52	14.17	15.19
	5-Year Median	17.97	17.18	16.97	17.45
P/S F12M	Current	1.56	1.2	1.04	3.08
	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	1.26	1.17	3.01
EV/EBITDA TTM	Current	10.76	14	10.33	10.17
	5-Year High	23.35	19.53	14.99	12.87
	5-Year Low	9	8.12	7.39	8.27
	5-Year Median	13.12	11.67	10.41	10.78

As of 04/09/2020

Industry Analysis Zacks Industry Rank: Top 32% (82 out of 253)



Top Peers

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

Industry Comparison Industry: Aerospace - Defense				Industry Peers		
	NOC Neutral	X Industry	S&P 500	BA Underperform	GD Neutral	LMT Neutral
VGM Score	A	-	-	F	A	C
Market Cap	56.32 B	7.83 B	19.66 B	85.51 B	40.92 B	104.52 B
# of Analysts	6	5	13	5	8	8
Dividend Yield	1.57%	0.78%	2.18%	0.00%	3.12%	2.59%
Value Score	C	-	-	D	B	C
Cash/Price	0.04	0.10	0.06	0.14	0.02	0.02
EV/EBITDA	16.65	10.12	11.72	119.90	8.93	12.60
PEG Ratio	1.14	1.59	2.04	NA	1.45	2.24
Price/Book (P/B)	6.40	2.90	2.66	NA	3.01	33.00
Price/Cash Flow (P/CF)	12.20	9.47	10.44	280.45	9.47	14.10
P/E (F1)	14.62	14.62	17.51	NA	11.46	15.38
Price/Sales (P/S)	1.66	0.88	2.12	1.12	1.04	1.75
Earnings Yield	6.84%	6.05%	5.65%	-0.81%	8.73%	6.50%
Debt/Equity	1.60	0.82	0.70	-2.41	0.66	3.60
Cash Flow (\$/share)	27.58	2.73	7.01	0.54	14.89	26.30
Growth Score	A	-	-	F	B	C
Hist. EPS Growth (3-5 yrs)	23.28%	13.39%	10.92%	14.14%	7.05%	16.29%
Proj. EPS Growth (F1/F0)	8.59%	11.46%	-1.14%	64.55%	2.75%	9.89%
Curr. Cash Flow Growth	2.21%	6.19%	5.93%	-97.35%	3.16%	18.08%
Hist. Cash Flow Growth (3-5 yrs)	14.43%	6.40%	8.55%	-48.30%	6.36%	9.70%
Current Ratio	1.13	1.22	1.24	1.05	1.18	1.22
Debt/Capital	61.48%	47.20%	42.36%	NA	39.89%	78.24%
Net Margin	6.64%	6.01%	11.64%	-0.83%	8.85%	10.42%
Return on Equity	39.51%	16.94%	16.74%	-70.76%	26.70%	198.95%
Sales/Assets	0.84	0.84	0.54	0.60	0.81	1.24
Proj. Sales Growth (F1/F0)	5.29%	0.60%	0.45%	0.56%	1.32%	6.64%
Momentum Score	A	-	-	F	B	C
Daily Price Chg	2.12%	2.77%	2.48%	3.38%	2.63%	2.65%
1 Week Price Chg	0.47%	-6.53%	-4.40%	-23.14%	-3.38%	0.61%
4 Week Price Chg	15.89%	7.77%	11.26%	-1.94%	6.64%	19.15%
12 Week Price Chg	-12.28%	-32.65%	-20.02%	-54.27%	-22.69%	-12.85%
52 Week Price Chg	21.36%	-14.65%	-11.31%	-58.98%	-17.75%	21.40%
20 Day Average Volume	1,472,365	1,511,190	3,931,994	45,742,920	2,663,099	2,574,947
(F1) EPS Est 1 week change	0.00%	0.00%	-0.12%	-5.31%	0.00%	0.00%
(F1) EPS Est 4 week change	-0.12%	-0.12%	-5.78%	-141.62%	-3.29%	0.00%
(F1) EPS Est 12 week change	0.43%	-3.41%	-7.64%	-108.10%	-4.55%	-0.57%
(Q1) EPS Est Mthly Chg	-0.18%	-0.18%	-10.13%	-266.67%	-5.80%	0.09%

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	A
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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