

Northrop Grumman(NOC)

\$326.01 (As of 07/30/20)

Price Target (6-12 Months): **\$346.00**

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:C

Value: C

Growth: D

Momentum: B

Summary

Northrop Grumman ended second-quarter 2020 on a strong note, with both its earnings and revenues surpassing the respective Zacks Consensus Estimate. As a major U.S. defense contractor, it 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 the Pentagon. The favorable amendments included in the fiscal 2021 defense budget proposal are expected to boost defense primes like Northrop's top line. The company has outperformed the industry in the past year. However, 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.

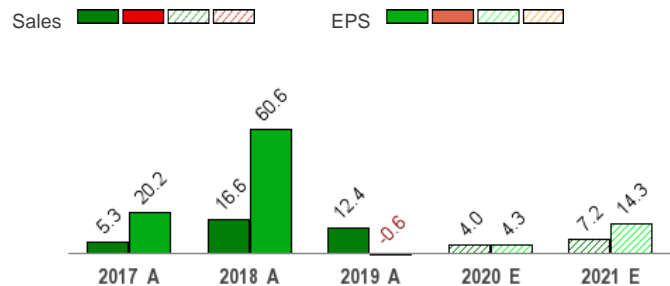
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$385.01 - \$263.31
20 Day Average Volume (sh)	1,004,148
Market Cap	\$54.3 B
YTD Price Change	-5.2%
Beta	0.79
Dividend / Div Yld	\$5.80 / 1.8%
Industry	Aerospace - Defense
Zacks Industry Rank	Bottom 25% (190 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	12.1%
Last Sales Surprise	3.4%
EPS F1 Est- 4 week change	0.2%
Expected Report Date	10/22/2020
Earnings ESP	0.0%
P/E TTM	14.7
P/E F1	14.7
PEG F1	1.2
P/S TTM	1.6

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	9,229 E	9,400 E	9,523 E	9,835 E	37,721 E
2020	8,620 A	8,884 A	8,803 E	9,181 E	35,192 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	\$6.09 E	\$6.17 E	\$6.41 E	\$6.53 E	\$25.28 E
2020	\$5.15 A	\$6.01 A	\$5.71 E	\$5.88 E	\$22.12 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 07/30/2020. The reports text is as of 07/31/2020.

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, the company 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. Northrop Grumman has realigned its business units effective January 2020.

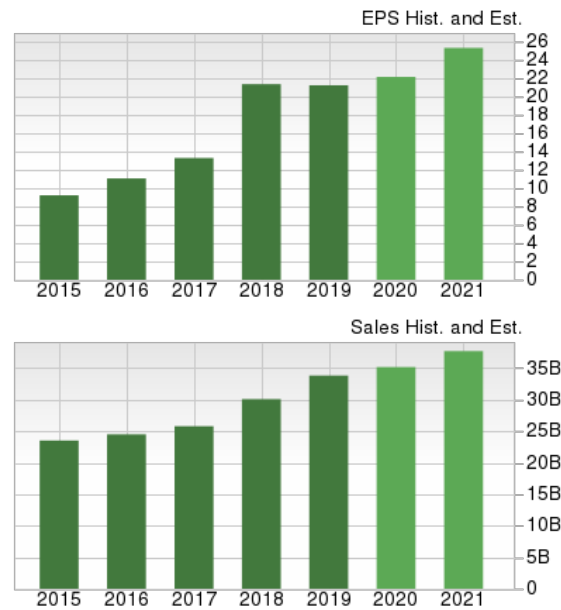
Aeronautics Systems unit focuses on the development, integration, production and support of manned aircraft and autonomous systems. Segmental revenues in second-quarter 2020 totaled \$2,925 million, representing 32.9% of the company's top line.

Defense Systems unit focuses on mission readiness along with battle management and missile systems. Segmental revenues in second-quarter 2020 totaled \$1,886 million, representing 21.2% of the company's top line.

Mission Systems unit includes airborne sensors and networks, cyber and intelligence mission solutions, maritime/land systems and sensors, along with navigation, targeting and survivability. Segmental revenues in second-quarter 2020 totaled \$2,446 million, representing 27.5% of the company's top line.

Space Systems unit focuses on launch and strategic missiles as well as varied space related products that Northrop manufactures. Segmental revenues in second-quarter 2020 totaled \$2,048 million, representing 23.1% of the company's top line.

However, total revenues of \$8,884 million in the second quarter were adjusted for intersegment eliminations of up to \$421 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 solid 5% sales growth in second-quarter 2020 compared with the year-ago quarter's figure, with majority 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 \$1.26 billion in the second quarter, comprising 14.2% 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 lost 5.7% in a year, compared to the industry's 28.8% decline.

▲ Northrop Grumman's cash and cash equivalents were \$4.18 billion at the end of second quarter 2020, compared with \$3.28 billion in the prior quarter. Its long-term debt was \$14.23 billion as of Jun 30, 2020, while it had no outstanding short-term commercial paper borrowings as of Jun 30, 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 had a current ratio of 1.36, as of Jun 30, 2020, compared with 1.29 as of Mar 31, 2020. 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 6.2 at the end of second-quarter 2020, up from 6 in the previous quarter. 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. As of Jun 30, 2020, Northrop made share repurchases worth \$490 million and raised its dividend by 10% in May. 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.

Reasons To Sell:

- ▼ Although the novel coronavirus outbreak did not have a significant impact on Northrop's second-quarter results, the company fears that the continued spread of COVID-19 is likely to cause extended disruption in its supply chain. If the company's suppliers face increased challenges with their workforce, access to necessary components and supplies, access to capital, and access to fundamental support services, they may be unable to provide the agreed-upon goods and services in a timely, compliant and cost-effective manner. Consequently, the defense giant may incur additional costs and delays in its business. The company expects that the longer the COVID-19 pandemic, including its economic disruption, continues, the greater the adverse impact will be on its operating results.
- ▼ 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 1.73. This level compares unfavorably with what the stock has witnessed in a year's time. Moreover, the company's EV/SALES ratio is higher than that of its sector's ratio of 1.49.
- ▼ 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 unfavorable EV/Sales ratio coupled with exposure to workplace related fatalities raise concerns. The rapid spread of the COVID-19 pandemic also poses risk for the stock

Last Earnings Report

Northrop Grumman Beats on Q2 Earnings, Ups '20 View

Northrop Grumman reported second-quarter 2020 earnings of \$6.01 per share, which surpassed the Zacks Consensus Estimate of \$5.36 by 12.1%. The bottom line also increased 19% from \$5.06 reported in the year-ago quarter.

Total Sales

In second-quarter 2020, Northrop Grumman reported total sales of \$8,884 million, which surpassed the Zacks Consensus Estimate of \$8,589 million by 3.4%. Sales also increased 5% from the year-ago quarter's \$8,456 million. The upside was primarily driven by a solid double-digit increase in the Space Systems' sales.

Backlog Count

Northrop Grumman's total backlog stood at \$70 billion at the end of second-quarter 2020 compared with \$64.84 billion at 2019-end. Of the total backlog, \$33.86 billion was funded.

Segmental Details

Effective Jan 1, 2020, Northrop made some structural changes in its reportable segments.

Aeronautics Systems: Segment sales of \$2,925 million grew 7% year over year as a result of higher sales from both autonomous systems and manned aircraft.

Operating income improved 4% to \$310 million, whereas operating margin contracted 40 basis points (bps) to 10.6%.

Mission Systems: Segment sales increased 2% to \$2,446 million, driven by higher sales volume from airborne sensors and network programs.

Operating income rose 3% to \$347 million, with operating margin expanding 10 bps to 14.2%.

Defense Systems: Sales at this segment declined 2% to \$1,886 million due to lower volumes in battle management & missile system programs.

Operating income increased 2% to \$217 million, while operating margin expanded 40 bps to 11.5%.

Space Systems: Space Systems' second-quarter 2020 sales increased 15% to \$2,048 million owing to higher sales from both Space and Launch & Strategic Missiles programs.

The segment's operating income improved 8% to \$209 million, while operating margin contracted 60 bps to 10.2%.

Operational Update

Total operating costs and expenses at the end of the quarter were \$7,890 million, up 5.1% from the year-ago quarter's \$7,510 million.

Operating income during the quarter increased 5% year over year to \$994 million.

Financial Condition

Northrop Grumman's cash and cash equivalents as of Jun 30, 2020, were \$4,178 million, up from \$2,245 million as of Dec 31, 2019.

Long-term debt (net of current portion) as of Jun 30, 2020, was \$14,259 million, up from \$12,770 million as of Dec 31, 2019.

Net cash inflow from operating activities as of Jun 30, 2020, was \$1,344 million compared with \$694 million as of Jun 30, 2019.

2020 Guidance

Northrop Grumman has raised its 2020 financial guidance and expects to generate revenues of \$35.3-\$35.6 billion. The Zacks Consensus Estimate for the company's full-year sales, pegged at \$35.19 billion, lies below its projected view.

It expects free cash flow of \$3.15-\$3.55 billion for 2020.

Northrop Grumman has also raised its full-year earnings expectations from \$21.80-\$22.20 to \$22.00-\$22.40 per share. The Zacks Consensus Estimate for the company's 2020 earnings, pegged at \$22.12, lies below the midpoint of the company's guidance.

Quarter Ending 06/2020

Report Date	Jul 30, 2020
Sales Surprise	3.44%
EPS Surprise	12.13%
Quarterly EPS	6.01
Annual EPS (TTM)	22.26

Recent News

On **Jun 26, 2020**, Northrop Grumman's business unit, Northrop Grumman Systems secured a modification contract for production and delivery of three MQ-4C Triton unmanned aircraft. The company will also offer associated export compliance support under the terms of the deal.

Valued at \$333.4 million, the contract will cater to the government of Australia. The deal, expected to be completed by April 2025, has been awarded by the Naval Air Systems Command, Patuxent River, MD. The majority of the task will be carried out in San Diego and Palmdale, CA; Red Oak, TX and Linthicum, MD.

On **Jun 2, 2020**, Northrop Grumman announced that it has been awarded modification contract that is worth no more than \$2.37 billion, for Phase 1 of the Next-Generation Overhead Persistent Infrared (Next-Gen OPIR) Polar program from the United States Space Force (USSF). The program's work will take place in Redondo Beach, Ca. Phase 2 of the contract award, to support production of the 2 NGP Block 0 satellites, is expected to take place in 2025.

On **May 29, 2020**, Northrop Grumman announced that it has successfully completed its fourth and final major design review with the U.S. Air Force under the technology maturation and risk reduction (TMRR) phase of the Ground Based Strategic Deterrent (GBSD) program

On **May 19, 2020**, Northrop Grumman announced that its board of directors have declared a quarterly dividend of \$1.45 per share on its common stock, payable June 17, 2020, to shareholders of record as of the close of business June 1, 2020. This reflects a solid 10% increase from the company's prior dividend rate.

Valuation

Northrop Grumman's shares are down 5.2% in the year to date period and 5.7% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Aerospace sector are down 24.6% and 31.4% in the year to date period, respectively. Over the past year, the Zacks sub-industry is down 28.8% and the Zacks Aerospace sector witnessed a 31.5% decline.

The S&P 500 index is up 1.3% in the year to date period and 9.7% in the past year.

The stock is currently trading at 13.6X forward 12-month earnings, which compares to 19.7X for the Zacks sub-industry, 19.8X for the Zacks sector and 22.7X for the S&P 500 index.

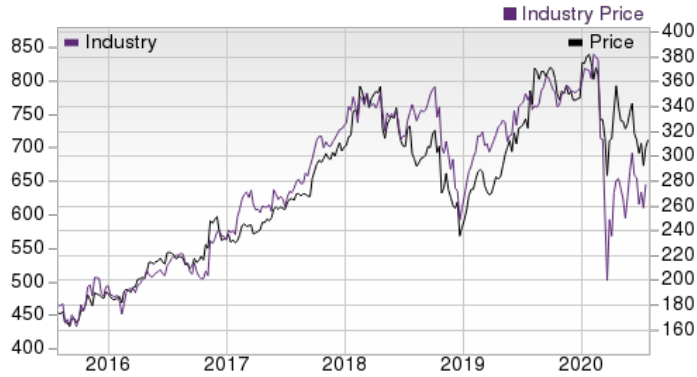
Over the past five years, the stock has traded as high as 25.4X and as low as 11.4X, with a 5-year median of 17.9X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$346 price target reflects 14.4X forward 12-month earnings.

The table below shows summary valuation data for NOC

Valuation Multiples - NOC					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	13.61	19.73	19.82	22.69
	5-Year High	25.37	22.54	20.94	22.69
	5-Year Low	11.35	14.52	14.17	15.25
	5-Year Median	17.93	17.75	17.24	17.55
P/S F12M	Current	3.59	1.25	1.18	3.61
	5-Year High	2.23	1.64	1.49	3.61
	5-Year Low	1.16	0.95	0.92	2.53
	5-Year Median	1.62	1.27	1.18	3.02
EV/EBITDA TTM	Current	10.42	19.04	11.65	12.12
	5-Year High	23.35	22.03	14.98	12.86
	5-Year Low	9	8.12	7.39	8.25
	5-Year Median	13.12	11.79	10.56	10.88

As of 07/30/2020

Industry Analysis Zacks Industry Rank: Bottom 25% (190 out of 253)



Top Peers

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

Industry Comparison Industry: Aerospace - Defense				Industry Peers		
	NOC	X Industry	S&P 500	BA	GD	LMT
Zacks Recommendation (Long Term)	Neutral	-	-	Underperform	Neutral	Neutral
Zacks Rank (Short Term)	3	-	-	5	4	3
VGM Score	C	-	-	F	D	A
Market Cap	54.35 B	9.20 B	22.57 B	91.41 B	42.70 B	107.05 B
# of Analysts	7	4	14	7	8	8
Dividend Yield	1.78%	0.11%	1.83%	0.00%	2.96%	2.51%
Value Score	C	-	-	F	C	A
Cash/Price	0.06	0.09	0.07	0.16	0.12	0.03
EV/EBITDA	16.28	10.32	12.96	168.77	8.71	12.81
PEG Ratio	1.15	2.39	3.04	NA	2.49	2.29
Price/Book (P/B)	5.60	3.18	3.13	NA	3.07	28.27
Price/Cash Flow (P/CF)	11.82	10.00	12.61	299.12	10.00	14.51
P/E (F1)	14.74	15.83	22.06	NA	13.37	15.83
Price/Sales (P/S)	1.57	1.11	2.42	1.37	1.11	1.70
Earnings Yield	6.79%	3.96%	4.31%	-3.87%	7.48%	6.32%
Debt/Equity	1.61	0.82	0.75	-5.14	0.75	3.22
Cash Flow (\$/share)	27.58	2.73	6.94	0.54	14.89	26.30
Growth Score	D	-	-	F	D	A
Hist. EPS Growth (3-5 yrs)	23.40%	14.53%	10.85%	-6.39%	6.71%	18.30%
Proj. EPS Growth (F1/F0)	4.28%	1.87%	-7.75%	-80.49%	-7.05%	9.87%
Curr. Cash Flow Growth	2.21%	11.64%	5.39%	-97.35%	3.16%	18.08%
Hist. Cash Flow Growth (3-5 yrs)	14.43%	7.38%	8.55%	-48.30%	6.36%	9.70%
Current Ratio	1.35	1.33	1.31	1.41	1.27	1.31
Debt/Capital	61.62%	46.71%	44.32%	NA	42.98%	76.28%
Net Margin	6.91%	5.82%	10.44%	-4.27%	8.47%	10.25%
Return on Equity	40.24%	13.20%	14.73%	-3.08%	24.10%	182.05%
Sales/Assets	0.82	0.79	0.52	0.47	0.76	1.29
Proj. Sales Growth (F1/F0)	3.99%	0.00%	-1.95%	-17.34%	-1.48%	8.29%
Momentum Score	B	-	-	B	C	D
Daily Price Chg	3.41%	-0.39%	-0.92%	-2.45%	-0.39%	-1.44%
1 Week Price Chg	1.91%	0.00%	0.37%	-1.08%	0.83%	4.81%
4 Week Price Chg	5.17%	1.86%	4.14%	-10.43%	1.06%	5.45%
12 Week Price Chg	0.58%	14.18%	12.21%	25.88%	17.09%	1.38%
52 Week Price Chg	-5.51%	-20.14%	-1.73%	-51.55%	-18.85%	5.13%
20 Day Average Volume	1,004,148	634,411	1,887,986	34,075,772	1,125,946	1,406,967
(F1) EPS Est 1 week change	0.16%	0.00%	0.00%	0.00%	-0.33%	0.00%
(F1) EPS Est 4 week change	0.16%	0.00%	0.38%	-10.76%	-0.33%	2.01%
(F1) EPS Est 12 week change	0.02%	-4.52%	-0.07%	-39.80%	-0.83%	2.06%
(Q1) EPS Est Mthly Chg	0.00%	0.00%	0.16%	-29.39%	0.14%	-1.17%

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	C
Growth Score	D
Momentum Score	B
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.

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