

Raytheon Company (RTN)

\$226.10 (As of 01/30/20)

Price Target (6-12 Months): **\$240.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 01/10/19)

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

Raytheon ended 2019 on a mixed note. While its fourth-quarter earnings surpassed the Zacks Consensus Estimate, revenues lagged the consensus mark. The company continues to heavily invest in technological upgrades, which, in turn, significantly boosted its growth trajectory. Its pending merger deal with United Technologies is expected to reward shareholders heftily. Lately, it has increased focus on Hypersonic systems. Raytheon continues to receive ample orders from the Pentagon and its foreign allies. Shares of the company have also outperformed its industry in the past six months. However, rising costs of steel may hurt the bottom line. The prospect of higher import tariffs on steel is a concern. In addition, Raytheon faces tough competition in the defense market. Furthermore, it is expected to incur notable merger related costs.

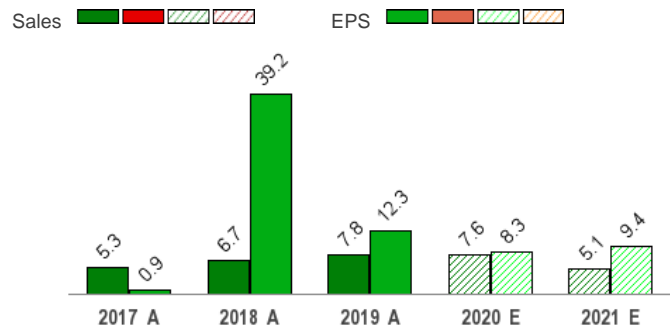
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$233.48 - \$164.76
20 Day Average Volume (sh)	1,777,947
Market Cap	\$63.0 B
YTD Price Change	2.9%
Beta	0.88
Dividend / Div Yld	\$3.77 / 1.7%
Industry	Aerospace - Defense Equipment
Zacks Industry Rank	Bottom 32% (174 out of 255)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	1.6%
Last Sales Surprise	-2.3%
EPS F1 Est- 4 week change	0.4%
Expected Report Date	04/23/2020
Earnings ESP	0.0%
P/E TTM	19.0
P/E F1	17.5
PEG F1	1.6
P/S TTM	2.2

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021					32,988 E
2020	7,199 E	7,553 E	7,941 E	8,552 E	31,398 E
2019	6,729 A	7,159 A	7,446 A	7,842 A	29,176 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021					\$14.13 E
2020	\$3.06 E	\$3.24 E	\$3.30 E	\$3.70 E	\$12.91 E
2019	\$2.77 A	\$2.92 A	\$3.08 A	\$3.16 A	\$11.92 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 01/30/2020. The reports text is as of 01/31/2020.

Overview

Based in Massachusetts, **Raytheon Company**, incorporated in 1922, is one of the largest aerospace and defense companies in the U.S. with a diversified line of military products, including missiles, radars, sensors, surveillance and reconnaissance equipment, communication and information systems, naval systems, air traffic control systems, and technical services.

The company operates through five business segments, namely, Intelligence, Information and Services; Integrated Defense Systems; Missile Systems; Space and Airborne Systems; and Forcepoint (formerly known as Raytheon|Websense).

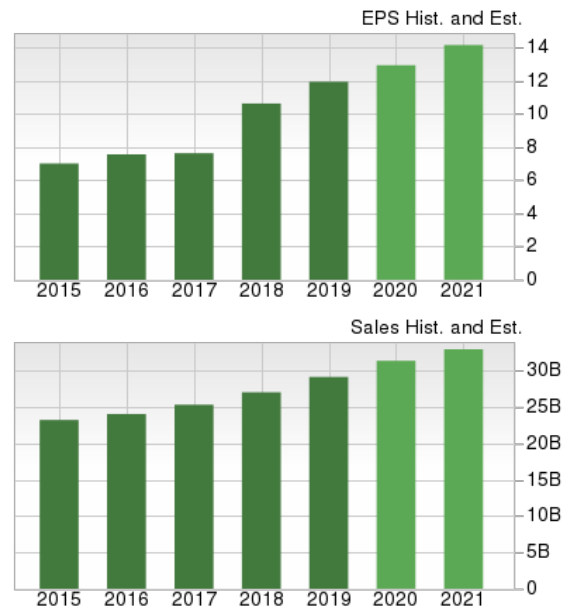
Intelligence, Information and Services (IIS) offers cyber security services. This segment generated sales of \$7,151 million in 2019, representing 24.5% of total business sales.

Integrated Defense Systems (IDS) mainly provides air and missile defense, large land- and sea-based radars and systems for managing command, control, communications, computers, cyber and intelligence (C5I). In 2019, it generated sales of \$6,927 million, representing 23.7% of total business sales.

Missile Systems (MS) designs, develops, and produces missile systems for critical requirements, including air-to-air strikes, surface navy air defense, land combat missiles, guided projectiles and directed energy weapons. In 2019, it generated sales of \$8,726 million, representing 29.9% of total business sales.

Space and Airborne Systems (SAS) manufactures radars and other sensors for aircraft, spacecraft and ships. Sales at this segment totaled \$7,427 million in 2019, representing 25.4% of total business sales.

Forcepoint provides unified web, email, mobile and data security solutions globally for protecting an organization's data and users from external and internal threats. Sales at this segment totaled \$658 million in 2019, representing 2.3% of total business sales. However, total revenues of \$29,177 million were adjusted for intersegment eliminations of \$1,712 million.



Reasons To Buy:

- ▲ Raytheon is one of the best-positioned large-cap defense players due to its non-platform-centric focus. The company heavily invests in technological upgrades, which in turn significantly boosts its growth trajectory. Lately, the company has increased its focus in hypersonics, realizing the fact that Hypersonic systems is the next wave of technology relative to advanced missile systems. Notably, the company is already under contract with the U.S. Defense Agency Research Projects Agency (DARPA) to develop the Hypersonic Air-Breathing Weapon Concept (HAWC) — an air-launched, scramjet-powered missile demonstrator. Raytheon is also developing the Tactical Boost Glide (TBG) weapon — a roughly 500-nm-range unpowered vehicle accelerated to hypersonic speed by a rocket booster. Moreover, in October, Raytheon was selected to develop the lower-tier Air and Missile Defense sensor, which extends its position as the world's premier Air and Missile Defense radar capability provider. Such meaningful innovation and order flow should further strengthen Raytheon's position in the U.S. defense market.
- ▲ Thanks to its wide range of combat-proven defense products, Raytheon continues to receive ample orders from the Pentagon and its foreign allies. In the fourth quarter, the company witnessed record bookings of \$12.1 billion, which improved 44% year over year. This translated into a 15% increase in the backlog to \$48.8 billion. These impressive results encourage the company to foresee solid bookings in the upcoming quarters, thereby bolstering its revenue growth prospects. In fact, a solid revenue growth in the past has been driving its better-than-expected earnings history. The company surpassed the Zacks Consensus Estimate in each of the trailing four quarters, with the average positive earnings surprise being 8.60%. Long-term earnings growth rate of the company is currently projected at 10.7% compared with its industry's rate of 9.8%. This makes it an attractive choice for investors.
- ▲ Raytheon's revenues primarily benefit from its varied missile systems. In particular, its Patriot missile-defense systems are gaining traction, both in domestic and international space. In August, the Kingdom of Bahrain signed an agreement to purchase Raytheon's Patriot system, thereby becoming the 17th nation to procure Patriot. With additional follow-on awards expected to be booked in 2020 and 2021, Raytheon continues to see market opportunity for its Patriot missiles in Romania to be around \$2 billion. Going ahead, the company expects the Phase II (Poland's two-phase medium-range Integrated Air and Missile Defense procurement) booking for Poland's Patriot program in 2020 to come with a total opportunity of around \$5 billion. These indicate the rapidly increasing demand for Raytheon's Patriot franchise. In the last six months, shares of Raytheon have gained 27% compared with its industry's 16.7% growth. This reflects investors' confidence over the company's growth potential.
- ▲ In June, Raytheon signed an all-stock merger deal with multinational conglomerate United Technologies Corp, which will generate a conglomerate worth almost \$121 billion. Per the terms of the latest agreement, Raytheon's shareowners will receive 2.3348 shares in the combined company for each of this missile maker's share. On completion of the merger, in the second quarter of 2020, Raytheon's shareowners will own approximately 43% of the combined company. Further, Raytheon's shareholders can expect return of capital in the range of \$18-\$20 billion during the first three years. Before the deal closes by first half of 2020, this stock should offer lucrative investing option for defense investors.

Technological innovations continue to boost Raytheon's growth trajectory. Merger news with United Technologies expected to boost Raytheon's shareholder value

Reasons To Sell:

- ▼ Rising costs of raw materials like steel are pushing up expenses for defense manufacturers like Raytheon. Moreover, the company fears that the tariffs being imposed by the U.S. administration on import of steel and aluminum may create or exacerbate existing materials shortages. Adding to these woes, in January 2020, President Trump announced plans to increase tariffs on foreign steel and aluminum, saying the existing tariffs had not proved as effective as he had hoped in reviving American production. This, in turn, will make it even more expensive for defense primes like Raytheon to manufacture valuable defense equipment, as America is the world's largest steel importer. So, even if the company generates solid revenues, rising raw material cost might hurt all those gains and in turn weigh on Raytheon's bottom line. Thus, we remain skeptical as to whether the new trade tariffs will be able to aid the U.S. defense industry or remain as a prominent headwind.
- ▼ The company's sales from international markets are subject to country-specific risk related to political stability and regime change. Its international sales are also subject to local government laws, regulations, and procurement policies and practices which may differ from U.S. government regulations. These include regulations relating to export-import control, technology transfer, investments, exchange controls and repatriation of earnings.
- ▼ Raytheon operates in a highly competitive market. Some competitors may have more extensive or specialized business segments. Meanwhile, some customers might develop their own products and directly compete with the company. In particular, its Forcepoint cybersecurity joint venture faces significant competition due to rapid changes in technology, products, customer specifications and industry standards. The company also has a wide range of market competitors, some that are significantly larger with broader product and service offerings or have best-of-breed products and/or maintain stronger customer relationships. This could turn out to be a major headwind for the company, going ahead.
- ▼ As the company is currently undergoing the procedure of merger with United Technologies, Raytheon is expected to incur notable merger related costs. Such costs are likely to drag down the company's bottom line and cash flow reserve in the near term.

Rising raw material costs pose a threat to the stock's growth. Stiff competition poses additional risk

Last Earnings Report

Raytheon's Q4 Earnings Surpass Estimates, Sales Up Y/Y

Raytheon reported fourth-quarter 2019 earnings per share (EPS) of \$3.16 from continuing operations, outpacing the Zacks Consensus Estimate of \$3.11 by 1.6%. The bottom-line figure also improved 7.8% from the year-ago quarter's \$2.93 owing to operational improvements.

For 2019, Raytheon's earnings came in at \$11.92 per share, which surpassed the Zacks Consensus Estimate of \$11.88 by 0.33%. The 2019 bottom-line figure also improved 17.4% from the prior-year number.

Quarter Ending **12/2019**

Report Date	Jan 30, 2020
Sales Surprise	-2.31%
EPS Surprise	1.61%
Quarterly EPS	3.16
Annual EPS (TTM)	11.93

Operational Performance

Raytheon's fourth-quarter sales of \$7,842 million grew 6.5% on a year-over-year basis. The top line, however, fell short of the Zacks Consensus Estimate of \$8,028 million by 2.3%.

For 2019, Raytheon generated sales of \$29.18 billion, which marginally missed the Zacks Consensus Estimate of \$29.35 billion by 0.58%. However, on a year-over-year basis, full-year sales improved 7.8%.

The company's bookings totaled \$12,058 million compared with \$8,447 million in the year-ago quarter, reflecting a surge of 42.7%. Total backlog at the end of 2019 was \$48.75 billion, up 14.9% from the previous year's figure.

Total operating expenses increased 6.8% to \$6,563 million. The company's operating income of \$1,279 million rose 5.4% year over year.

Segmental Performance

Integrated Defense Systems: Sales at this segment grew 18% year over year to \$1,981 million, driven by higher net sales from an international air and missile defense system program and an international missile defense radar program. Meanwhile, operating income in the reported quarter also grew 24% to \$307 million from \$247 million a year ago.

Intelligence, Information and Services: Sales at this segment totaled \$1,742 million, higher than the year- ago level of \$1,711 million by 2%. Operating income in the reported quarter also improved 3% to \$149 million

from \$144 million a year ago.

Missile Systems: Revenues at this segment grew 1% to \$2,345 million from \$2,317 million a year ago, owing to higher net sales on classified programs in 2019. Moreover, operating income improved 9% to \$297 million from \$273 million in the year-ago quarter.

Space and Airborne Systems: At this segment, revenues grossed \$2,018 million that witnessed 7% growth from the year-ago quarter. This upside was driven by increased net sales from classified programs, Next Generation Overhead Persistent Infrared (Next Gen OPIR) program and tactical communication system programs. Also, operating income rose 6% to \$278 million on higher volumes.

Forcepoint: This commercial cybersecurity segment generated net revenues of \$177 million in the fourth quarter, up 2.9% from \$172 million a year ago.

Moreover, operating income in the reported quarter surged 200% to \$6 million from \$2 million a year ago.

Financial Update

Raytheon ended 2019 with cash and cash equivalents of \$4,292 million, up from \$3,608 million as of Dec 31, 2018.

Long-term debt summed \$3,261 million, as of Dec 31, 2019, down from \$4,755 million, as of Dec 31, 2018.

Net cash inflow from operating activities amounted to \$4,480 million in 2019 compared with \$3,428 million in 2018.

Recent News

On **Jan 15, 2020**, Raytheon announced that it has delivered its 10th AN/AQS-20C mine-hunting sonar system to the U.S. Navy. The sonar-towed body was officially transferred to the Naval Surface Warfare Center, Panama City Division. The system – which is the program of record for the Navy's Littoral Combat Ship mine countermeasure mission package – is now fully qualified and will move toward initial operating capability.

On **Dec 20, 2019**, Raytheon Company's Missile Systems (MS) business division secured a \$1 billion contract to meet full rate production requirements, spares and round design agent for Standard missile SM-6. The deal was awarded by the Naval Sea Systems Command, Washington, DC.

The majority of work related to the deal will be executed in East Camden, AR, Huntsville, AL and Wolverhampton, United Kingdom. The project is expected to be completed by October 2026.

Valuation

Raytheon's shares are up 27% in the past six months period and up 38.9% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Aerospace sector are up 16.2% and 10.4% in the past six months period, respectively. Over the past year, the Zacks sub-industry is up 37.4% whereas the sector rose 19.1%.

The S&P 500 index is up 12.7% in the past six months period and 23% in the past year.

The stock is currently trading at 17.37X of forward 12-month earnings, which compares to 20.91X for the Zacks sub-industry, 19.21X for the Zacks sector and 18.83X for the S&P 500 index.

Over the past five years, the stock has traded as high as 24.97X and as low as 12.38X, with a 5-year median of 17.79X. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$240 price target reflects 18.43X forward 12-month earnings.

The table below shows summary valuation data for RTN

Valuation Multiples - RTN					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	17.37	20.91	19.21	18.83
	5-Year High	24.97	20.91	21.54	19.34
	5-Year Low	12.38	14.51	14.26	15.18
	5-Year Median	17.79	17.96	16.85	17.46
P/S F12M	Current	2	1.42	1.36	3.49
	5-Year High	2.43	1.93	1.39	3.49
	5-Year Low	1.28	1.09	0.8	2.54
	5-Year Median	1.72	1.42	1.06	3
EV/EBITDA TTM	Current	12.01	13.57	12.99	12.25
	5-Year High	13.13	13.57	13.24	12.86
	5-Year Low	8.61	9.02	7.28	8.48
	5-Year Median	10.24	10.28	9.97	10.7

As of 01/30/2020

Industry Analysis Zacks Industry Rank: Bottom 32% (174 out of 255)



Top Peers

Leidos Holdings, Inc. (LDOS)	Outperform
Bae Systems PLC (BAESY)	Neutral
FLIR Systems, Inc. (FLIR)	Neutral
General Dynamics Corporation (GD)	Neutral
Kratos Defense & Security Solutions, Inc. (KTOS)	Neutral
Lockheed Martin Corporation (LMT)	Neutral
Northrop Grumman Corporation (NOC)	Neutral
Teledyne Technologies Incorporated (TDY)	Neutral

Industry Comparison Industry: Aerospace - Defense Equipment				Industry Peers		
	RTN Neutral	X Industry	S&P 500	GD Neutral	LMT Neutral	NOC Neutral
VGM Score	B	-	-	C	C	A
Market Cap	62.96 B	1.57 B	23.91 B	52.43 B	122.95 B	64.86 B
# of Analysts	8	2	13	9	9	8
Dividend Yield	1.67%	0.00%	1.77%	2.25%	2.20%	1.37%
Value Score	C	-	-	B	C	C
Cash/Price	0.04	0.04	0.04	0.02	0.02	0.02
EV/EBITDA	16.49	14.77	14.07	11.62	17.19	15.25
PEG Ratio	1.56	2.48	2.00	1.63	2.74	1.28
Price/Book (P/B)	5.15	3.48	3.27	3.86	38.78	7.35
Price/Cash Flow (P/CF)	15.95	15.55	13.48	12.16	16.57	14.03
P/E (F1)	17.51	23.85	18.76	14.03	18.02	16.74
Price/Sales (P/S)	2.16	1.86	2.61	1.33	2.06	1.92
Earnings Yield	5.71%	4.21%	5.32%	7.13%	5.55%	5.97%
Debt/Equity	0.32	0.33	0.72	0.66	3.60	1.60
Cash Flow (\$/share)	14.17	2.52	6.88	14.91	26.30	27.44
Growth Score	B	-	-	C	A	A
Hist. EPS Growth (3-5 yrs)	11.92%	12.34%	10.68%	7.41%	14.78%	22.40%
Proj. EPS Growth (F1/F0)	8.34%	9.58%	7.73%	7.81%	10.20%	8.39%
Curr. Cash Flow Growth	9.30%	9.45%	12.29%	3.16%	18.08%	2.21%
Hist. Cash Flow Growth (3-5 yrs)	7.51%	4.09%	8.78%	6.79%	6.70%	14.12%
Current Ratio	1.34	2.34	1.23	1.18	1.22	1.13
Debt/Capital	24.65%	29.72%	43.16%	39.89%	78.24%	61.48%
Net Margin	11.46%	7.81%	11.59%	8.85%	10.42%	6.64%
Return on Equity	27.22%	9.39%	17.38%	26.70%	198.95%	39.51%
Sales/Assets	0.89	0.75	0.54	0.81	1.24	0.84
Proj. Sales Growth (F1/F0)	7.62%	3.95%	4.05%	4.27%	5.69%	5.71%
Momentum Score	B	-	-	F	F	A
Daily Price Chg	-0.54%	0.00%	-0.21%	-1.22%	0.47%	0.58%
1 Week Price Chg	-0.04%	-1.73%	-1.09%	1.75%	1.61%	0.44%
4 Week Price Chg	0.72%	2.00%	-0.01%	1.57%	9.15%	8.20%
12 Week Price Chg	5.16%	4.23%	4.14%	-0.94%	15.09%	12.07%
52 Week Price Chg	37.23%	21.34%	17.24%	5.88%	50.47%	39.67%
20 Day Average Volume	1,777,947	109,444	1,824,613	1,329,056	1,285,874	1,023,731
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	-1.69%	-0.48%	0.33%
(F1) EPS Est 4 week change	0.36%	0.00%	0.00%	-1.84%	-0.47%	0.25%
(F1) EPS Est 12 week change	0.06%	0.01%	-0.11%	-1.82%	-0.67%	1.01%
(Q1) EPS Est Mthly Chg	0.00%	0.00%	0.00%	-7.59%	1.17%	0.92%

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	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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