

## Huntington Ingalls Industries

## Labor remains a revolving door

Reiterate Rating: UNDERPERFORM | PO: 210.00 USD | Price: 230.54 USD

## Hiring improves, retention remains an issue

HII talent acquisition strategy targeting high school grads, community colleges, and apprentice schools has been successful. HII hired 3,200 new craftsmen in the first half of the year, making steady progress toward the goal of 5,000. Management noted attrition rates have improved but are above pre-covid levels. New hires, attrition, and retirement from seasoned veterans weighs on productivity which we see as a material risk to meeting shipbuilding milestones. There is potential upside during this generational turnover to realize incremental gains on EAC adjustments as contracts are priced on current efficiency levels.

## Demand environment remains strong, significant new wins

HII continues to benefit from Congress supporting increasing shipbuilding. The Armed Services Committee included authorizing funding for the LDP 33, and multi-year procurement of the next block of Virginia class submarines (VA SSN). While the final bill has yet to be enacted, we see the support from both the Senate & House for shipbuilding as a positive. The unified view should help mitigate the risk of lower funding to shipbuilding. Recent wins for Shipbuilding included: ~\$1bn win for 6 DDG-51 ships and \$0.9bn in submarine modification wins. MT was also awarded \$280mn in new U.S. Navy engineering and dev. support and training systems integration contracts.

## Pressure is on for 4Q deliveries

Shipbuilding had a strong first half of the year and is expected to slow in the second half. Management outlook on 3Q anticipates results in-line with 2Q, which puts significant pressure on 4Q deliveries. Given the previously mentioned labor constraints in addition to the SSN 801 Utah being pushed out to 2024 we do see risks on HII meeting the three scheduled deliveries, two launches, and one float off.

## Reiterate Underperform and \$210 PO

We lower our estimates and reiterate Underperform. We derive our PO of \$210 (unchanged) using a 0.6x P/FCF multiple relative to the S&P 500 on 2024 estimates (unchanged). See further valuation rationale inside note.

Estimates (Dec) (US\$)	2021A	2022A	2023E	2024E	2025E
EPS	13.50	14.44	14.50	17.70	19.35
GAAP EPS	13.50	14.44	14.50	17.70	19.35
EPS Change (YoY)	-21.2%	7.0%	0.4%	22.1%	9.3%
Consensus EPS (Bloomberg)			13.94	15.99	17.43
DPS	4.60	4.78	5.02	5.52	6.08
Valuation (Dec)					
P/E	17.1x	16.0x	15.9x	13.0x	11.9x
GAAP P/E	17.1x	16.0x	15.9x	13.0x	11.9x
Dividend Yield	2.0%	2.1%	2.2%	2.4%	2.6%
EV / EBITDA*	17.5x	16.1x	13.8x	11.9x	11.3x
Free Cash Flow Yield*	4.7%	5.2%	4.8%	7.3%	5.8%

\* For full definitions of *IQmethod*<sup>SM</sup> measures, see page 5.

08 August 2023

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## Stock Data

Price	230.54 USD
Price Objective	210.00 USD
Date Established	22-Feb-2023
Investment Opinion	B-3-7
52-Week Range	188.51 USD - 260.02 USD
Mkt Val (mn) / Shares Out (mn)	9,191 USD / 39.9
Average Daily Value (mn)	60.70 USD
BofA Ticker / Exchange	HII / NYS
Bloomberg / Reuters	HII US / HII.N
ROE (2023E)	15.8%
Net Dbt to Eqty (Dec-2022A)	69.9%
ESGMeter™	High

ESGMeter is not indicative of a company's future stock price performance and is not an investment recommendation or rating. ESGMeter is independent of BofA Global Research's equity investment rating, volatility risk rating, income rating, and price objective for that company. For full details, refer to "BofA ESGMeter Methodology".

## Acronyms:

EW – Electronic warfare  
LVC – Live, Virtual, and Constructive  
PRESS - Personnel Recovery  
Enterprise Services & Solutions Program

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Timestamp: 08 August 2023 03:00AM EDT

# iQprofile<sup>SM</sup> Huntington Ingalls Industries

## iQmethod<sup>SM</sup> – Bus Performance\*

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Return on Capital Employed	6.4%	5.5%	6.5%	7.9%	8.4%
Return on Equity	23.1%	18.4%	15.8%	17.5%	17.6%
Operating Margin	5.4%	5.3%	6.2%	7.2%	7.5%
Free Cash Flow	429	482	441	671	533

## iQmethod<sup>SM</sup> – Quality of Earnings\*

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Cash Realization Ratio	1.4x	1.3x	1.2x	1.4x	1.1x
Asset Replacement Ratio	1.6x	1.3x	1.2x	1.2x	1.2x
Tax Rate	12.5%	19.5%	21.0%	21.0%	21.0%
Net Debt-to-Equity Ratio	95.1%	69.9%	58.1%	46.2%	44.0%
Interest Cover	5.8x	5.5x	6.5x	8.6x	9.1x

## Income Statement Data (Dec)

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Sales	9,524	10,676	10,960	11,339	11,731
% Change	1.7%	12.1%	2.7%	3.5%	3.5%
Gross Profit	1,368	1,440	1,533	1,643	1,758
% Change	-18.1%	5.3%	6.5%	7.1%	7.0%
EBITDA	720	783	909	1,054	1,113
% Change	-27.3%	8.8%	16.1%	16.0%	5.6%
Net Interest & Other Income	109	154	52	66	74
<b>Net Income (Adjusted)</b>	<b>544</b>	<b>579</b>	<b>577</b>	<b>701</b>	<b>750</b>
<b>% Change</b>	<b>-21.8%</b>	<b>6.4%</b>	<b>-0.3%</b>	<b>21.3%</b>	<b>7.1%</b>

## Free Cash Flow Data (Dec)

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Net Income from Cont Operations (GAAP)	544	579	577	701	750
Depreciation & Amortization	207	218	231	234	237
Change in Working Capital	(136)	(192)	19	4	(178)
Deferred Taxation Charge	98	2	(62)	0	0
Other Adjustments, Net	47	159	(52)	16	16
Capital Expenditure	(331)	(284)	(273)	(283)	(293)
<b>Free Cash Flow</b>	<b>429</b>	<b>482</b>	<b>441</b>	<b>671</b>	<b>533</b>
<b>% Change</b>	<b>-42.0%</b>	<b>12.4%</b>	<b>-8.6%</b>	<b>52.3%</b>	<b>-20.6%</b>

## Balance Sheet Data (Dec)

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Cash & Equivalents	627	467	454	447	444
Trade Receivables	1,743	1,876	1,923	1,988	2,153
Other Current Assets	420	403	470	473	535
Property, Plant & Equipment	3,107	3,198	3,240	3,290	3,346
Other Non-Current Assets	4,730	4,913	4,786	4,677	4,578
<b>Total Assets</b>	<b>10,627</b>	<b>10,857</b>	<b>10,873</b>	<b>10,876</b>	<b>11,057</b>
Short-Term Debt	0	399	484	484	484
Other Current Liabilities	2,427	2,496	2,647	2,722	2,796
Long-Term Debt	3,298	2,506	2,196	1,887	1,887
Other Non-Current Liabilities	2,094	1,967	1,717	1,621	1,513
<b>Total Liabilities</b>	<b>7,819</b>	<b>7,368</b>	<b>7,044</b>	<b>6,714</b>	<b>6,680</b>
<b>Total Equity</b>	<b>2,808</b>	<b>3,489</b>	<b>3,829</b>	<b>4,162</b>	<b>4,376</b>
<b>Total Equity &amp; Liabilities</b>	<b>10,627</b>	<b>10,857</b>	<b>10,873</b>	<b>10,876</b>	<b>11,057</b>

\* For full definitions of iQmethod<sup>SM</sup> measures, see page 5.

## Company Sector

Defense Electronics

## Company Description

Headquartered in Newport News, VA, HII is split between three operating segments, Ingalls, Newport News, and Mission Technologies. It supplies and builds amphibious assault and expeditionary ships, builds National Security Cutters and DDG-51s, designs, builds and refuels nuclear-powered aircraft carriers, designs and builds nuclear-powered submarines and provides design, engineering, construction and life cycle support of major surface ship programs for the U.S. Navy.

## Investment Rationale

HII is a pure play on the US Navy. The company is a direct beneficiary of the U.S. pivot to the Pacific and the incrementally positive outlook for the U.S. Navy spending. The Pacific is a hotbed of maritime activity particularly as China expands its territorial waters. As the U.S. focuses more on naval superiority and improving global presence without committing ground troops, we may see upside to shipbuilding spending. That said, we think it is largely reflected in the valuation at this time.

## Stock Data

Average Daily Volume 263,300

## Quarterly Earnings Estimates

	2022	2023
Q1	3.50A	3.23A
Q2	4.44A	3.27E
Q3	3.44A	3.18E
Q4	3.07A	4.82E

## Strong growth, while margins compressed

Huntington Ingalls Industries (NYSE: HII) reported second quarter revenue of \$2.8bn. Shipbuilding revenue grew 3.9% Y/Y driven by increased volumes on Aircraft carriers, Columbia & Virginia-class submarines, and delivery of the DDG-125. Mission Technologies (MT) revenue increased 7.5% Y/Y driven by mission solutions in (C5ISR, Cyber/EW, and LVC). Shipbuilding margins declined 623bps Y/Y on lower favorable changes in contract estimates from facilities capital and economic price adjustments. MT's adjusted EBITDA margin of 6.7% increased 100bps Y/Y, adjusting 2Q23 for the one-time \$15mn gain related to the ship repair and specialty fabrication joint venture.

## EPS estimates reflecting continued shipyard constraints

We lower our 2023 EPS estimate to \$14.50 (vs. prior of \$14.95), on updated share count estimates and continued labor constraints impacting deliveries from shipyards. In the outyears the higher share count is partially offset by lower interest expense. 2024: \$17.70 (vs. prior \$17.85), 2025: \$19.35 (vs. prior \$19.80), 2026: \$21.75 (vs. prior \$22.30), 2027: \$23.65 (vs. prior \$24.30).

## Reiterate Underperform and \$210 PO

We still expect supply chain and labor constraints to offset the long-term upside of US Navy fleet expansion. Additionally, the current low growth outlook of 3% annually at shipbuilding leaves much to be desired in topline performance when the DoD and Navy are pulling all demand levers. Ultimately, we believe there are better opportunities in the market for Naval modernization exposure. We derive our PO of \$210 using a P/FCF multiple of 0.6x (unchanged) relative to the S&P 500 on 2024 estimates, resulting in a 12.5x multiple. This is below the historical average of 0.8x and factors in robust Navy exposure in a rising defense spending environment offset by persistent supply chain and labor challenges.



## Price objective basis & risk

### Huntington Ingalls Industries (HII)

We derive our PO of \$210 using a P/FCF multiple of 0.6x relative to the S&P 500 on 2024 estimates, resulting in a 12.5x multiple. This is below the historical average of 0.8x and factors in robust Navy exposure in a rising defense spending environment offset by persistent supply chain and labor challenges.

Upside risks to our PO are: if the US government's "pivot to the Pacific" strategy involves procuring more ships than we forecast and margins continue to expand beyond expected. Higher share repurchases could provide upside to reported EPS. Accretive acquisitions could increase future expected earnings.

Downside risks to our PO are: Cost overruns derail the company's plan to maintain operating margins above 9%. The Navy takes a budget cut and reduces current fleet procurement. Weaker than expected synergies from announced acquisitions.

## Analyst Certification

I, Ronald J. Epstein, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

### US - Aerospace and Defense Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
<b>BUY</b>				
	AerCap Holdings N.V.	AER	AER US	Ronald J. Epstein
	Air Lease Corporation	AL	AL US	Ronald J. Epstein
	Boeing	BA	BA US	Ronald J. Epstein
	BWX Technologies, Inc.	BWXT	BWXT US	Ronald J. Epstein
	CACI International	CACI	CACI US	Mariana Perez Mora
	Cadre Holdings Inc	CDRE	CDRE US	Ronald J. Epstein
	Crane Co.	CR	CR US	Ronald J. Epstein
	Embraer	ERJ	ERJ US	Ronald J. Epstein
	General Dynamics	GD	GD US	Ronald J. Epstein
	Howmet Aerospace Inc.	HWM	HWM US	Ronald J. Epstein
	KBR	KBR	KBR US	Mariana Perez Mora
	Leidos Holdings	LDOS	LDOS US	Mariana Perez Mora
	Northrop Grumman	NOC	NOC US	Ronald J. Epstein
	Palantir Technologies	PLTR	PLTR US	Mariana Perez Mora
	Rocket Lab	RKLB	RKLB US	Ronald J. Epstein
	Teledyne Technologies Inc	TDY	TDY US	Ronald J. Epstein
	TransDigm Group Inc.	TDG	TDG US	Ronald J. Epstein
	Triumph Group	TGI	TGI US	Ronald J. Epstein
<b>NEUTRAL</b>				
	Albany International	AIN	AIN US	Ronald J. Epstein
	Booz Allen Hamilton	BAH	BAH US	Ronald J. Epstein
	CAE Inc.	YCAE	CAE CN	Ronald J. Epstein
	CAE Inc.	CAE	CAE US	Ronald J. Epstein
	Garmin	GRMN	GRMN US	Ronald J. Epstein
	HEICO Corporation	HEI	HEI US	Ronald J. Epstein
	Hexcel Corporation	HXL	HXL US	Ronald J. Epstein
	L3Harris	LHX	LHX US	Ronald J. Epstein
	Lockheed Martin	LMT	LMT US	Ronald J. Epstein
	Raytheon Tech	RTX	RTX US	Ronald J. Epstein
	Textron	TXT	TXT US	Ronald J. Epstein
<b>UNDERPERFORM</b>				
	Astra Space Inc.	ASTR	ASTR US	Ronald J. Epstein
	Bombardier	BDRBF	BDRBF US	Ronald J. Epstein
	Bombardier Inc.	YBBD B	BBD/B CN	Ronald J. Epstein

**US - Aerospace and Defense Coverage Cluster**

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
	Huntington Ingalls Industries	HII	HII US	Ronald J. Epstein
	Parsons Corporation	PSN	PSN US	Mariana Perez Mora
	RBC Bearings Inc	RBC	RBC US	Ronald J. Epstein
	Spire Global inc	SPIR	SPIR US	Ronald J. Epstein
	Spirit AeroSys-A	SPR	SPR US	Ronald J. Epstein
	Terran Orbital Corporation	LLAP	LLAP US	Ronald J. Epstein
	Virgin Galactic Holdings	SPCE	SPCE US	Ronald J. Epstein

**iQmethod<sup>SM</sup> Measures Definitions****Business Performance**

Return On Capital Employed

Return On Equity  
Operating Margin  
Earnings Growth  
Free Cash Flow

**Quality of Earnings**

Cash Realization Ratio  
Asset Replacement Ratio  
Tax Rate  
Net Debt-To-Equity Ratio  
Interest Cover

**Valuation Toolkit**

Price / Earnings Ratio  
Price / Book Value  
Dividend Yield  
Free Cash Flow Yield  
Enterprise Value / Sales

EV / EBITDA

**Numerator**

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization

Net Income  
Operating Profit  
Expected 5 Year CAGR From Latest Actual  
Cash Flow From Operations – Total Capex

**Numerator**

Cash Flow From Operations  
Capex  
Tax Charge  
Net Debt = Total Debt – Cash & Equivalents  
EBIT

**Numerator**

Current Share Price  
Current Share Price  
Annualised Declared Cash Dividend  
Cash Flow From Operations – Total Capex  
EV = Current Share Price × Current Shares + Minority Equity + Net Debt + Other LT Liabilities  
Enterprise Value

**Denominator**

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill  
Amortization  
Shareholders' Equity  
Sales  
N/A  
N/A

**Denominator**

Net Income  
Depreciation  
Pre-Tax Income  
Total Equity  
Interest Expense

**Denominator**

Diluted Earnings Per Share (Basis As Specified)  
Shareholders' Equity / Current Basic Shares  
Current Share Price  
Market Cap = Current Share Price × Current Basic Shares  
Sales

Basic EBIT + Depreciation + Amortization

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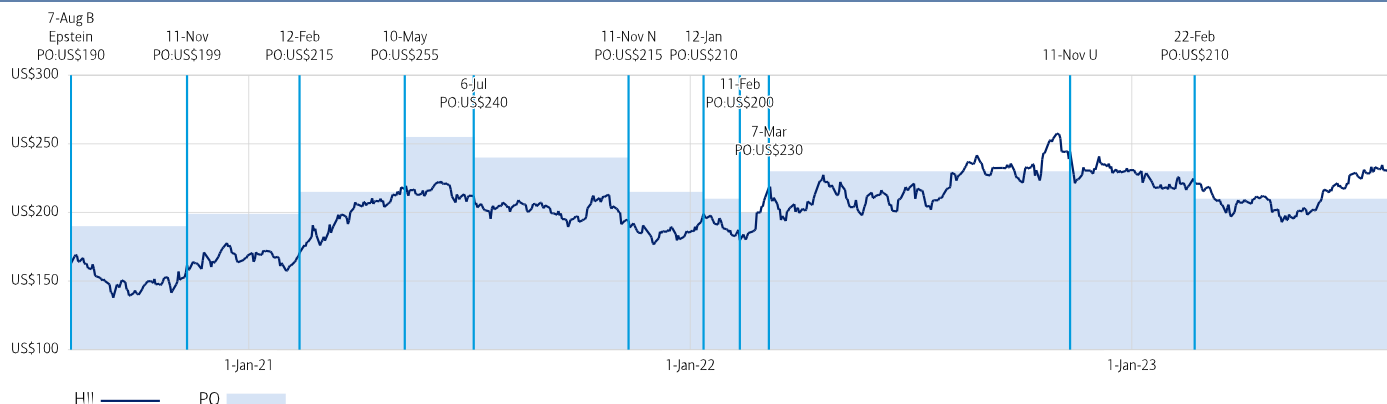
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## Important Disclosures

### Huntington Ing Ind (HII) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

### Equity Investment Rating Distribution: Aerospace/Defense Electronics Group (as of 30 Jun 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	25	50.00%	Buy	17	68.00%
Hold	14	28.00%	Hold	13	92.86%
Sell	11	22.00%	Sell	4	36.36%

### Equity Investment Rating Distribution: Global Group (as of 30 Jun 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	1877	53.28%	Buy	1040	55.41%
Hold	815	23.13%	Hold	464	56.93%
Sell	831	23.59%	Sell	385	46.33%

<sup>R1</sup> Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster <sup>R2</sup>
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

<sup>R2</sup> Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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