

Northrop Grumman

Strong quarter slayed by B-21 LRIP charge, reiterate Buy

Maintain Rating: BUY | PO: 615.00 USD | Price: 434.55 USD

Adj. EPS excl. B-21 LRIP charge beats STe and BofAe

Northrop Grumman (NYSE: NOC) reported 4Q23 GAAP EPS of \$(3.53) (vs. BofAe: \$5.69 vs. BBG: \$5.80). The miss was driven by the combined impact of B-21 LRIP charge of \$1.56bn (\$7.72/share and \$1.17bn net of deferred tax benefits) and MTM pension expense (\$2.09/share). Adj. EPS of \$6.28 excluding these charges was above BofAe and consensus. We reiterate our Buy on otherwise strong performance across the segments.

Gross B-21 charge above exp. range, future looks brighter

We note that the gross B-21 charge of \$1.56bn is well above the prior provided range of possible charges (\$0-1.2bn). Additionally, previous language indicated that it was possible one or more LRIP options might be performed at a loss. Now, it seems likely that each of the five LRIP lots will be performed at a loss given macroeconomic conditions and higher than expected manufacturing costs. On the bright side, it appears as though LRIP options are being awarded earlier than expected, as indicated by recent news that the B-21 was approved for low-rate production in Fall 2023. NOC's "mature plans for manufacturing" supported the DoD's push to move to production.

2024 outlook: \$40.8-41.2bn sales, \$24.45-24.85 adj. EPS

NOC provided 2024 expectations of \$40.8-41.2bn sales (vs. consensus \$41.1bn vs. BofAe \$41.0bn) MTM pension adjusted EPS of \$24.45-24.85 (vs. consensus \$24.22 vs. BofAe \$23.80), and FCF of \$2.25-2.65bn (vs. consensus \$2.5bn vs. BofAe \$2.6bn).

Exhibit 1: 4Q23 NOC Results

The miss was driven by the combined impact of B-21 LRIP charge and MTM pension expense

Quick-take of results vs. Expectations:	
EPS	4Q23: \$6.28 vs. BofAe: \$5.69 vs. BBG: \$5.80 vs. 4Q22: \$7.50 (GAAP \$(3.54)) (4Q23 down 16.3% Y/Y)
Revenue	4Q23: \$10,638mn vs. BofAe: \$10,300mn vs. BBG: \$10,436mn vs. 4Q22: \$10,033mn (4Q23 up 6.0% Y/Y)
Operating Margin	4Q23: 3.7% vs. BofAe: 10.1% vs. 4Q22: 9.0%
Revenue by segment	Aeronautics Systems: 4Q23: \$2,910mn vs. BofAe: \$2,866mn vs. 4Q22: \$2,757mn Defense Systems: 4Q23: \$1,645mn vs. BofAe: \$1,529mn vs. 4Q22: \$1,657mn Mission Systems: 4Q23: \$3,063mn vs. BofAe: \$2,915mn vs. 4Q22: \$2,927mn Space Systems: 4Q23: \$3,602mn vs. BofAe: \$3,648mn vs. 4Q22: \$3,278mn Intersegment sales: 4Q23: \$-582mn vs. BofAe: \$-658mn vs. 4Q22: \$-586mn
Operating segment margin	Aeronautics Systems: 4Q23: 43.7% vs. BofAe: 8.5% vs. 4Q22: 10.5% Defense Systems: 4Q23 Actual: 12.3% vs. BofAe: 11.9% vs. 4Q22: 11.0% Mission Systems: 4Q23 Actual: 15.1% vs. BofAe: 16.0% vs. 4Q22: 15.4% Space Systems: 4Q23 Actual: 8.4% vs. BofAe: 10.0% vs. 4Q22: 9.1%
FCF	4Q23 Actual: \$1,627mn vs. BofAe: \$1,593mn vs. BBG: \$1,551mn vs. 4Q22: \$1,674mn (declined 2.8% Y/Y)
Backlog	\$83,931mn vs. \$79,649 in 3Q22

Source: BofA Global Research, Bloomberg

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Stock Data

Price	434.55 USD
Price Objective	615.00 USD
Date Established	28-Jul-2023
Investment Opinion	B-1-7
52-Week Range	414.56 USD - 496.89 USD
Mkt Val (mn) / Shares Out (mn)	65,527 USD / 150.8
Free Float	90.3%
Average Daily Value (mn)	311.63 USD
BofA Ticker / Exchange	NOC / NYS
Bloomberg / Reuters	NOC US / NOC.N
ROE (2023E)	21.7%
Net Dbt to Eqty (Dec-2022A)	60.3%
ESGMeter™	High

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DoD – Department of Defense

LRIP: Low Rate initial Production

UAV: Unmanned Aerial Vehicle

GMLRS: Guided Multiple Launch Rocket System

SDA: Space Defense Agency

Segment growth drivers: Space and Aero lead the way

Aeronautics saw stronger sales driven by higher volumes on classified programs, Triton UAV, and E-2. Defense Systems came in above expectations on higher GMLRS sales partially offset by poor timing of material receipts on Integrated Air and Missile Defense Battle Command System (IBCS) program. Mission systems tailwinds included higher classified sales of advanced electronics and higher marine systems volumes, offsetting lower volumes on airborne radars. Space Systems came in roughly in line with BofAe growth was attributed higher volumes on classified programs and the ramp up on development programs like the SDA Tranche 2 Transport Layer and NextGen Polar programs.

Price objective basis & risk

Northrop Grumman (NOC)

We derive our PO of \$615 based on a DCF analysis that reflects a 5% Y/Y growth rate for 2025-2030e, a 2.7% long term growth rate and a 7.7% discount rate. The US Defense Budget Authorization has grown at a 1.8% CAGR in constant dollars since post World War II. Considering the most profitable production phase of the B-21 Raider program starts in about ten years and the GBSD will enter production at the end of this decade, we expect NOC's next terminal growth rate could exceed the historical growth rate of US defense spending.

Downside risks to our PO are that execution risk on defense programs could result in cost overruns and margin contractions, and unexpected cancellations to programs in both commercial and military could materially impact NOC.

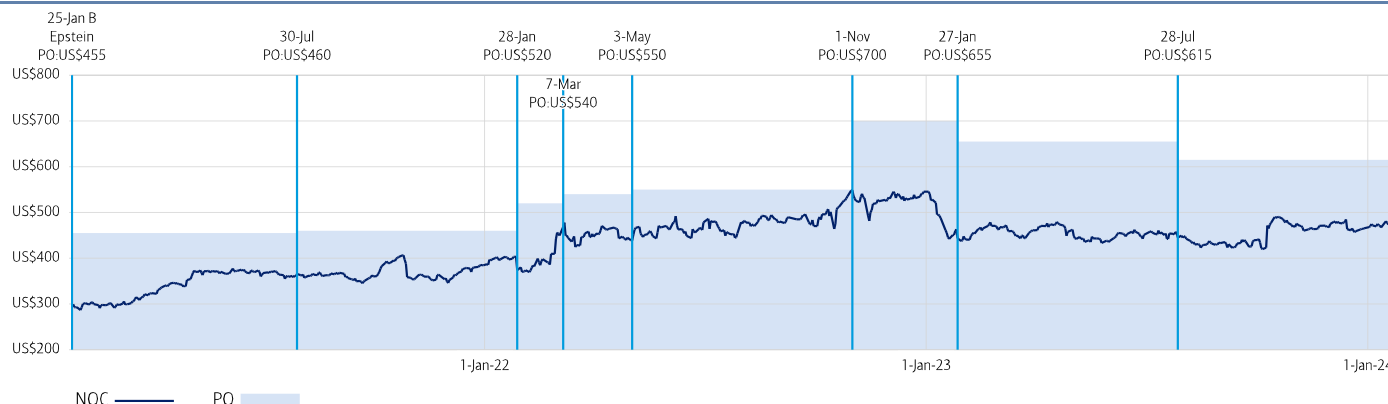
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Northrop Grumman (NOC) Price Chart



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

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Equity Investment Rating Distribution: Aerospace/Defense Electronics Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	31	62.00%	Buy	23	74.19%
Hold	11	22.00%	Hold	9	81.82%
Sell	8	16.00%	Sell	6	75.00%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

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