



Huntington Ingalls Industries

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Agenda

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 - Porter's 5 Forces
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Business Description

Divisions

Newport News Shipbuilding

- U.S. Navy Nuclear Powered Aircraft Carriers (CVN)
- U.S. Navy Nuclear Powered Submarines
 - Attack Submarines (SSN)
 - Ballistic Missile Submarines (SSBN)
- Refueling Vessels
- Complex Overhaul and Carrier Deactivation



Ingalls Shipbuilding

- U.S. Navy Surface Combatant Ships
 - Varied
- Amphibious Warships
- U.S. Coast Guard National Security Cutters



Technical Solutions

- U.S. Navy Fleet Support and Repair
- Software and IT Solutions
- Cybersecurity
- Intelligence Analysis
- Department of Energy Nuclear Research, Reactor Operations, and Maintenance



Select Financial Performance and Sector Breakdown

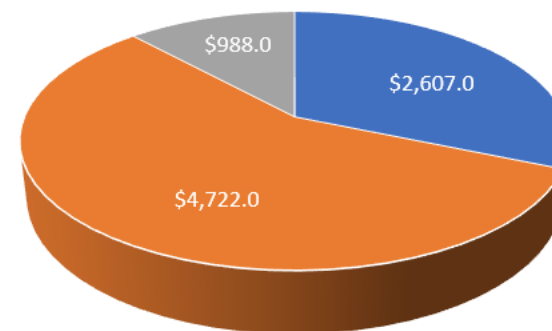
Select FY2018 Performance

	(\$mm)
Ingalls Shipbuilding	
Amphibious Assault Ships	1,348
Surface Combatant Ships	1,253
Other	6
	\$2,607
Newport News Shipbuilding	
Aircraft Carriers	2,605
Submarines	1,476
Other	641
	\$4,722
Technical Solutions	
Gov't and Energy Services	799
Oil and Gas Services	189
	\$988
Intersegment Eliminations	(141)
Total Revenues	\$8,176

Revenue Per Sector (%)

	% of Revenue
Ingalls Shipbuilding	31.3%
Newport News Shipbuilding	56.8%
Technical Solutions	11.9%

Revenue Per Segment (\$mm)



■ Ingalls Ship Building ■ Newport News Shipbuilding ■ Technical Solutions

Revenue by End Customer

	(\$mm)
Federal Government	7,908
State and Local Governments	2
Commercial	266
Total Revenues	\$8,176

Industry Overview

Industry at a Glance

Military Spending and Shipbuilding

Strong military spending is projected to continue well into the future, driven by the need to keep pace with quickly militarizing nations, mainly China. The U.S. Navy's 30 Year Shipbuilding Plan foresees production of at least 64 new ships through 2050 (Current US Naval Force: 291 battle-ready ships)

FY 2018 Naval Budget totaled \$171.5B, including \$49.5B for weapons procurement

FY 2019 Naval Budget totals \$194.1B, allotting \$58.5B for procurement and \$63.4B for Operations and Maintenance. This represents an 13% total increase from the FY 2018 budget

Figure 3.1. Major Weapons Programs

(\$ in billions)

Weapon Systems		FY 2018*		FY 2019	
		Qty	PB Request	Qty	PB Request
Ships					
SSN 774	VIRGINIA Class Submarine	2	5.5	2	7.4
DDG 51	ARLEIGH BURKE Destroyer	2	4.0	3	6.0
CVN 78	FORD Aircraft Carrier	1	4.6	--	1.8
LCS	Littoral Combat Ship	2	1.7	1	1.3
T-AO	Fleet Replenishment Oiler	1	0.5	2	1.1
ESB	Expeditionary Sea Base	--	--	1	0.7
T-ATS	Towing, Salvage, and Rescue Ship	1	0.1	1	0.1

Source: U.S. Navy Budget and 30 Year Shipbuilding Plan

Fragmented Manufacturing

The production of Naval Systems is highly fragmented, often including hundreds of suppliers in the production of a finished system. Huntington Ingalls Industries experiences a relative monopoly in the case of final large-ship assembly and manufacture

Long-Term Contracts

Military spending, and shipbuilding in particular, are driven by long-term government contracts which often span many years. The high cost of project abandonment, especially with warships, makes termination of these contracts unlikely

Porter's 5 Forces

Power of Suppliers: Medium

- Huntington Ingalls Industries sources material from a small number of specialized manufacturers. While much of the sourced material is commodity in nature (Steel), it often requires specialized production methods and transportation due to the size and engineered nature of the product

Degree of Competition: Low

- While competition amongst manufacturers of sub-systems, components, and electronics is relatively high, there are few other firms who compete for full product assembly of warships and other maritime assets in the U. S.
- Prior to HII's founding in 2011, competition existed between a few shipbuilders including Northrup Grumman Shipbuilding. Since then, NGS has spun-off its division and consolidated to form Huntington Ingalls Industries

Threat of New Entrants: Low

- The U.S. DoD has a long history of contracting large projects through a limited number of manufacturers. The sheer size and required expertise for these government contracts makes new market entrants unlikely

Threat of Substitutes: Low

- Very few, if any, current potential substitutes
- The concept of switching to other shipbuilding substitutes includes high costs in R&D, feasibility testing, and procurement, making the likelihood of such a change even less likely

Power of Buyers: Medium

- While the DoD and Navy Procurement Office have vast sums of money distributable to producers of various equipment, low industry competition in the Shipbuilding segment leaves few alternatives for the DoD to contract through

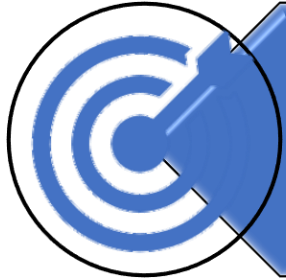
Competitors



Company	Ticker	Total Revenue (\$mm)	Market Capitalization (\$mm)	EV/EBITDA	Area of Competition
Lockheed Martin Corporation	NYSE:LMT	58,345	106,835	12.8x	Surface Combatant and Transport Ships
Raytheon Company	NYSE:RTN	28,694	59,873	14.0x	Surface Combatant Ships and Electric Submarines
General Dynamics Corporation	NYSE:GD	38,955	52,803	12.3x	Surface Combatant Ships (Destroyers) and Electric Submarines
L3Harris Technologies, Inc.	NYSE:LHX	9,690	43,081	12.9x	Surface Combatant and Patrol Ships
Average		33,921	65,648	13.0x	

Investment Thesis

Thesis Highlights



Strong Financial Performance

- 3-year average revenue growth of 7.5%
- Low current debt load of 14.3% of capital structure with room for further leverage
- Stable EBITDA margins with 3-year average margins of 13.8%



Contractual Growth

- Strong and predictable future revenue streams
- Currently contracted to build 9-10 Ford Class Aircraft Carriers along with 12 SSBN's and many other Surface Combatant ships
- Long-term revenue streams attributable to MRO of current naval fleet



Production Capabilities

- Huntington Ingalls is the only shipbuilder in the U.S. who can accommodate the size requirements and necessary capabilities to procure modern aircraft carriers and assemble nuclear powered submarines

Risks

Risk Analysis

Risk 1: 2020 Election Outcome

- Historically, democratic officials have pushed for lower military spending and cuts to the current armed forces. The market will likely respond negatively in the Defense sector should President Donald Trump fail to get reelected
- Although democrats generally attempt to reduce overall military spending, the Obama administration increased the Navy's procurement of ships during his presidency, showing some hope that a democratic presidency would not lead to drastic cuts to future shipbuilding

Risk 2: Increased Competitor Activity

- Many industry competitors currently make alternatives to some variants of surface combatant ships. It is possible that these competitors may expand their operations to compete directly with ships produced by Huntington Ingalls Industries
- Some of HII's larger competitors, such as Northrup Grumman and General Dynamics, have the necessary capital resources and expertise to expand into other market segments, such as submarine production

Valuation and Public Market Comparables

Public Market Comparables

Company	Market Data				LTM Operating Data and Forward Projections								
	Market Cap	% of 52 Week High	Enterprise Value (EV)	LTM Revenue	Gross Margin	EBITDA Margin	EV/Sales		EV/EBITDA		Sales Growth		P/E LTM
							LTM	CY18	LTM	CY19	LTM	3 YR	LTM
Prime Contractors													
Airbus SE	\$ 113,593	97.2%	\$ 118,523	\$ 75,732	14.5%	9.7%	1.5x	1.7x	15.2x	18.4x	13.1%	2.7%	30.4x
BAE Systems plc	23,983	95.5%	28,416	22,027	63.3%	11.7%	1.3x	1.3x	10.1x	11.4x	5.2%	0.5%	19.5x
General Dynamics Corporation	52,803	78.3%	67,231	38,955	17.7%	14.0%	1.73x	1.858x	12.4x	12.8x	14.3%	8.2%	20.8x
Lockheed Martin Corporation	106,835	86.6%	118,973	58,345	14.0%	15.8%	2.0x	2.2x	12.8x	14.1x	9.7%	9.0%	25.2x
Northrop Grumman Corporation	57,879	74.8%	72,586	33,276	20.6%	15.1%	2.2x	2.4x	14.5x	14.5x	16.8%	11.8%	26.5x
Raytheon Company	59,873	95.9%	63,306	28,694	26.9%	15.7%	2.2x	2.3x	14.0x	16.7x	8.4%	5.9%	24.8x
Textron Inc.	10,758	30.8%	14,284	13,280	16.8%	12.3%	1.1x	1.0x	8.7x	9.0x	-6.3%	-1.3%	16.4x
The Boeing Company	201,091	42.2%	216,366	86,989	13.2%	7.5%	2.5x	2.1x	33.0x	15.5x	-10.8%	-2.8%	83.3x
Mean	78,352	75.2%	87,461	44,662	23.4%	12.7%	1.8x	1.9x	15.1x	14.1x	6.3%	4.2%	30.9x
Median	58,876	82.5%	69,909	36,116	17.3%	13.1%	1.9x	2.0x	13.4x	14.3x	9.0%	4.3%	25.0x
Huntington Ingalls Industries, Inc.	10,243	95.4%	11,932	8,686	18.1%	11.2%	1.4x	1.5x	12.2x	9.9x	8.9%	7.2%	22.9x

Discounted Cash Flow Analysis

Free Cash Flow Buildup									
\$mm					Projected Annual Financials				
	2016A	2017A	2018A	2019E	2020P	2021P	2022P	2023P	2024P
Period					1	2	3	4	5
Total Revenues	7,068.0	7,441.0	8,176.0	8,771.0	9,092.9	9,426.7	9,772.7	10,131.4	10,503.2
EBITDA	1,038.0	1,058.0	1,211.0	1,005.6	1,254.4	1,300.4	1,348.2	1,397.7	1,449.0
EBIT	852.0	853.0	1,008.0	780.3	1,007.6	1,044.6	1,083.0	1,122.7	1,163.9
Tax Rate	26.9%	38.0%	13.9%	15.0%	15.0%	15.0%	15.0%	15.0%	15.0%
EBIAT	622.8	528.9	867.9	663.3	856.5	887.9	920.5	954.3	989.3
Depreciation and Amortization	191.0	211.0	207.0	244.3	246.8	255.8	265.2	274.9	285.0
Change in NWC		18.0	150.0	(179.3)	(18.0)	(18.6)	(19.3)	(20.0)	(20.7)
Capital Expenditures	(285.0)	(382.0)	(463.0)	(433.5)	(449.5)	(466.0)	(483.1)	(500.8)	(519.2)
Unlevered Free Cash Flows	528.8	375.9	761.9	294.7	635.8	659.2	683.4	708.4	734.4
Discount Rate (WACC)					8.19%	8.19%	8.19%	8.19%	8.19%
Discount Factor					92.43%	85.43%	78.96%	72.98%	67.46%
Present Value of Free Cash Flows					\$ 587.69	\$ 563.13	\$ 539.59	\$ 517.04	\$ 495.44
Sum of Present Values of FCF's					\$ 2,702.89				

Discounted Cash Flow Analysis

Cost of Equity (Ke)

Rf	1.92%	(10yr)
B	1.19	(5 yr)
(Rm - Rf)	5.96%	(Damadoran 2019)

Cost of Equity 9.01%

Terminal Value

Growth in Perpetuity

Long-Term Growth Rate	4.70%
WACC	8.19%
Terminal Value	\$ 14,855.51
Present Value of Terminal Value	\$ 10,021.11

WACC

Cost of Debt	3.83%
Tax Rate	15.00%
After-Tax Cost of Debt	3.26%
Cost of Equity	9.01%

Total Debt (\$)	\$ 1,721.0
Total Equity (\$)	\$ 10,343.6
Total Capital	\$ 12,064.6

Debt Weighting	14.3%
Equity Weighting	85.7%

WACC 8.19%

Enterprise Value

Sum of Present Values of FCF's	\$ 2,702.89
Present Value of Terminal Value	\$ 10,021.11
Enterprise Value	\$ 12,724.01
Enterprise Value	\$ 12,724.01
Debt	\$ (1,721.00)
Cash	\$ 32.0
Equity Value	\$ 11,035.01
Equity Value Per Share	\$ 267.19

Recent Share Price	\$ 250.45
30 Day Moving Average	\$ 216.39

DCF Premium (Discount) to Recent Price	6.68%
DCF Premium (Discount) to 30d MA	23.48%

DCF Sensitivity Analysis – Per Share Valuation

Growth in Perpetuity

		LT Growth Rate (%)		
		4.20%	4.70%	5.20%
WACC (%)	9.19%	\$176.98	\$194.97	\$217.46
	8.19%	\$235.92	\$267.19	\$309.92
	7.19%	\$335.86	\$399.79	\$495.85