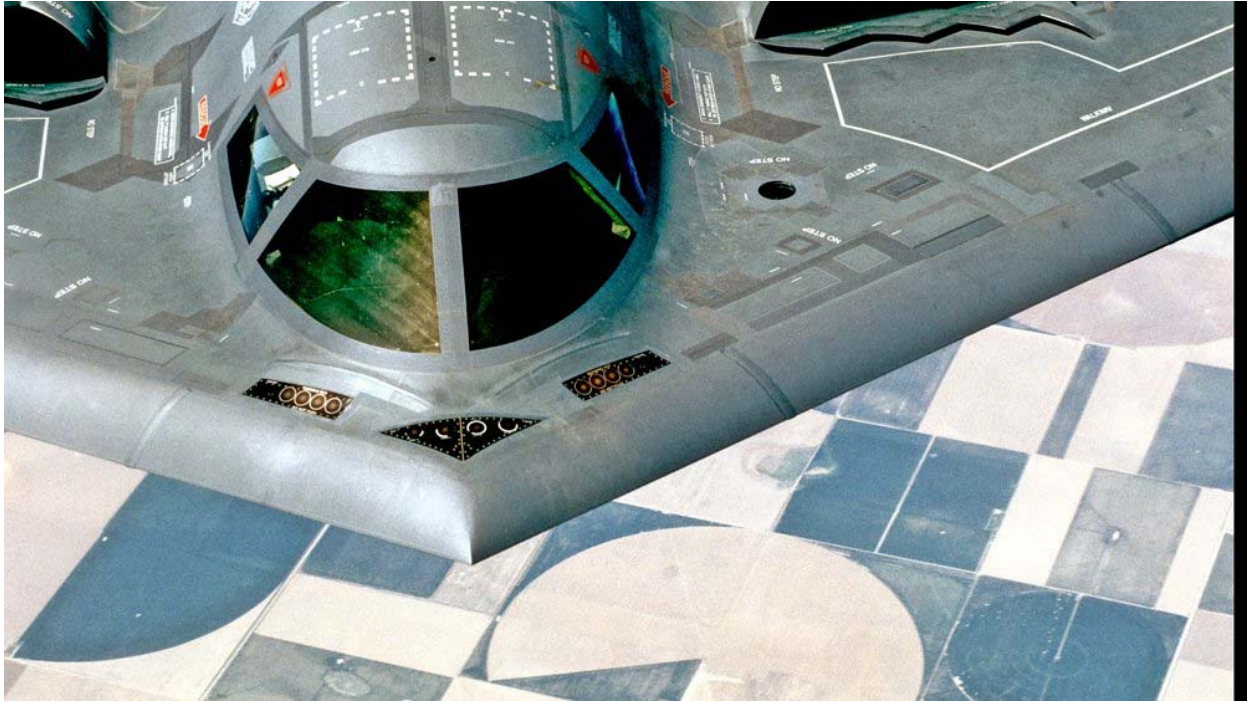


## Northrop Poised To Capitalize On Bomber, Pentagon Offerings

By: Gillian Rich

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Northrop Grumman's B-2 stealth bomber, which first flew in 1989, may have helped the company win its current long-range bomber contract. (Ken Murray/Zuma Press/Newscom)

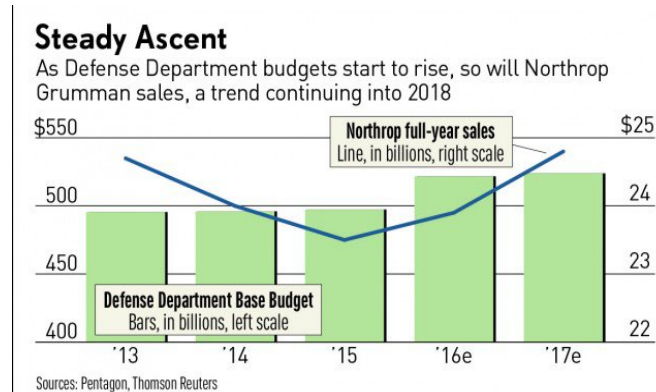
These are turning out to be prosperous times for long-time Pentagon supplier Northrop Grumman.

**Northrop** ([NOC](#)) can restart work on its new, potentially lucrative long-range strike bomber, after **Boeing's** ([BA](#)) protest of the contract's award was denied last week.

Production is increasing for several key programs of which the aerospace giant has been a part, thus ensuring that it has business for several years to come.

And while rising tensions with China and Russia may be bad news for international relations, they ultimately could boost demand for other Northrop offerings.

“Northrop is a well-balanced company that’s tightly managed and focuses on its niche offerings and (is) not diversified too far outside that,” said Richard Pettibone, aerospace and defense analyst at Forecast International.



In October, Northrop beat out a team of Boeing and **Lockheed Martin (LMT)** to develop the long-range strike bomber, the last major airframe contract expected to be issued by the Pentagon for the next decade. The Air Force hopes to get funding for 80 to 100 of the new planes.

If it passes, the production contract would be worth \$50 billion to \$80 billion. The planes would replace the Boeing B-52 bombers, which last year entered their seventh decade of service.

Air Force Secretary Deborah James said that Northrop’s development bid was the “best value” for the nation. Mark Bobbi, a defense analyst at consultancy IHS, said, “(Northrop) has the best chance of executing on this bomber program than any company in the world”; he estimates that the contract will add \$300 million-\$400 million to Northrop’s top line this year.

There’s always a caveat with defense contracts, though. Northrop has yet to win a production deal. And there’s always the chance that the bomber program will be cancelled, particularly if the cost exceeds forecasts of \$564 million per aircraft. A previous bomber program was cancelled suddenly in 2009.

Due to the deal’s secretive nature, details as to exactly why Northrop won development of the bomber won’t be released to the public. Bobbi speculates that Northrop won because of its legacy with the B-2 stealth bomber and its track record with the E-2D Hawkeye radar aircraft for the Navy. There’s also the perception that Northrop’s integration, subsystems and supply chain are better than its competitors’.

### **Other Prospects**

Along with the strike bomber and the Global Hawk unmanned surveillance aircraft — another key contract — Northrop is a supplier for Lockheed’s F-35 next-generation fighter jets. The

ramp-up in production of the F-35 and the extension of Northrop's F/A-18 Super Hornet combat jet for the Navy and Marine Corps will also help Northrop's top line this year.

On top of all that, the Air Force is expected to make a decision next year about the \$10 billion T-X trainer jet program with contract proposals to replace its 500 T-38 jets due in the fourth quarter. Northrop, Boeing, Lockheed and **Raytheon (RTN)** all have thrown their hats into the ring. But Pettibone said that it's unlikely Northrop would win the contract as the Pentagon is expected to consider the industrial base when offering the contract and would want to spread the work out.

Still, the Unmanned Carrier-Launched Airborne Surveillance and Strike (UCLASS) drone is up for grabs, and the Navy awarded four preliminary design contracts in 2014 to Boeing, General Atomics, Lockheed Martin and Northrop. A front runner has yet to emerge on the program.

Further, Northrop specializes in next-generation radar, expected to be a priority for the services going forward.

Northrop is part of IBD's Aerospace/Defense group along with peers Boeing, Lockheed and Raytheon. It also makes sensors and radar, missile and navigation systems.

The company's total backlog at the end of 2015 was \$35.9 billion vs. \$38.2 billion at the end of 2014. It got \$5.8 billion in new awards in the fourth quarter. Looking ahead, the company sees full-year EPS of \$9.90-\$10.20 on sales of \$23.5 billion-\$24 billion. Analysts polled by Thomson Reuters expect EPS of \$10.49 on sales of \$24.47 billion.

Northrop says that it sells products and services to customers in 25 nations. But international sales are only roughly 15% of Northrop's total revenue, as the U.S. services continue to be its main customer. In the 2017 budget request, the Defense Department asked for \$582.7 billion in military funding, with \$523.9 billion in base budget funding and \$58.8 billion in overseas contingency operations funding. The main military request is up 0.4% from the 2016 budget of \$580.3 billion.

## Constant Defense

The U.S. defense budget is likely to stay at current levels no matter who wins the 2016 presidential election, Chris Higgins of Morningstar told IBD. He says that the election outcome should have “marginal effects” on defense spending.

The risk of sequestration has also been mitigated, and there is little appetite to cut defense anymore, Pettibone says, as hot spots around the world erupt.

### Northrop Grumman

[www.northropgrumman.com](http://www.northropgrumman.com)

Ticker	NOC
Share price	Near 192
12-month sales	\$23.5 bil
5-year profit growth rate	11%

#### IBD SmartSelect Corporate Ratings

Composite Rating	91
Earnings Per Share	82
Relative Price Strength	92
Industry Group Rank	39
Rank Within Industry Group	3
Sales+Profit Margins+ROE	B
Accumulation/Distribution	D-

See [Investors.com](http://Investors.com) for more details

The fight against terrorism, particularly the Islamic State, isn't as much an advantage to Northrop as it is to Raytheon and Lockheed, since Northrop deals less in precision missile-guidance sales.

But Bobbi says that rising tensions with Russia and China will help the company as countries raise their defense budgets. He said that Eastern European nations have raised their defense budgets by a combined 20% in the past year. International sales had been a focal point for defense contractors after domestic sales were curbed during sequestration.

Still there are risks for Northrop. For one, there are fewer U.S. contract awards to go around, so the defense industry could be heading towards another round of consolidation like that seen in the 1990s when Lockheed merged with Martin Marietta, Northrop bought Grumman, and Boeing purchased McDonnell Douglas.

Analysts say that a smaller industrial base could actually cut costs, as the current fragmented defense sector creates inefficiencies. But the Pentagon is pushing for more power to block defense mergers and preserve competition. It is asking Congress for a stronger hand when it comes to industry dealmaking.

“I think the Defense Department would resist that with its entire essence,” Bobbi said of the prospect of Boeing buying Northrop. “You take out another prime contractor and put it under the wing of one that doesn't have a stellar track record.”

Pettibone, however, cautions to “never say never” about consolidation. Still, he sees further mergers as unlikely unless government regulators are content with having only two major players left, Boeing and Lockheed.

“Northrop will continue to be a constant and conservative player in the defense industry,” Pettibone said. “Management has planned for this environment and has the company going in eyes wide open to capitalize on the defense market going forward.”

Source: <http://www.investors.com/research/the-new-america/northrop-eyes-wide-open-to-capitalize-on-bomber-uav-offerings/>