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LHX - Q1 2020 L3Harris Technologies Inc Earnings Call

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## MAY 05, 2020 / 1:00PM, LHX - Q1 2020 L3Harris Technologies Inc Earnings Call

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**PRESENTATION****Operator**

Greetings, and welcome to the L3Harris Technologies First Quarter Calendar Year 2020 Earnings Call. (Operator Instructions)

It is now my pleasure to introduce your host, Mr. Rajeev Lalwani, Vice President, Investor Relations. Thank you. You may begin.

**Rajeev Lalwani** - *L3Harris Technologies, Inc. - VP*

Thank you, Jess. Good morning, everyone, and welcome to our first quarter calendar year 2020 earnings call. On the call with me today are Bill Brown, our CEO; Chris Kubasik, our COO; and Jay Malave, our CFO.

First, a few words on forward-looking statements and non-GAAP measures. Forward-looking statements involve risks, assumptions and uncertainties that could cause actual results to differ materially. For more information, please see the press release, the presentation and our SEC filings. A reconciliation of non-GAAP financial measures to comparable GAAP measures is included in the Investor Relations section of our website, which is [l3harris.com](http://l3harris.com), where a replay of this call will also be available. And to aid with year-over-year comparability following the L3Harris merger, prior year results will be on a pro forma basis as reflected in the 8-K filed yesterday.



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With that, Bill, I'll turn it over to you.

**William M. Brown** - L3Harris Technologies, Inc. - Executive Chairman & CEO

Okay. Well, thank you, Rajeev, and good morning, everyone. As we're all aware, the environment has changed considerably since our last update due to the global COVID-19 pandemic. Our top priority remains the safety and well-being of our employees while continuing to deliver the mission essential products and services to our customers. And I will start by thanking all of our employees for their hard work and dedication through this crisis. While we have a resilient portfolio and customer base and we're well positioned, we're not immune to the effects of COVID-19.

Despite the solid start to the year, we're trimming our outlook for revenue and earnings per share due principally to our commercial aerospace exposure and our recently completed divestiture, plus an anticipated softness in international and public safety and potential risks from supply chain disruption. We moved quickly with cost and other actions to offset these headwinds, holding earnings per share within 2% of our prior guidance while increasing our margin outlook and maintaining free cash flow. Our core U.S. government business, which represents about 75% of revenue, is performing well and without significant challenges.

Earlier today, we reported first quarter results with non-GAAP earnings per share of \$2.80, up 21% on 5% revenue growth. Company margins increased 170 basis points to 17.5%, and adjusted free cash flow was \$533 million. Total company-funded book-to-bill was 1.11 driving funded backlog up 3% versus the prior year. These results were ahead of our expectations. We're actively assessing and monitoring global developments and continue to use best practices to mitigate risks related to COVID-19. We've mandated work from home for those who can, implemented social distancing and canceled all travel and external events. In our production facilities, we've staggered work shifts, redesigned stations and implemented stringent cleaning protocols. As of today, all our facilities are up and running with limited disruptions reported to date.

We continue to receive a great deal of support from our key customers, the DOD, FAA, NASA and others, and a large majority of our programs and facilities as well as those of our suppliers have been deemed essential to national security. The DoD has moved quickly to adjust the terms of progress payments to drive cash into the industrial base, which we have passed through to our small suppliers and started a dialogue with industry on how to size and cover COVID-19-related costs. These measures combined with potential tax deferral benefits through the Cares Act provides some risk mitigation for our company and supply chain.

Looking at our credit profile, our balance sheet remains healthy, and we expect to have over \$3.5 billion in liquidity in the form of cash on hand and revolver availability at the end of the quarter. Jay will discuss this in some more detail.

In these uncertain times, we continue to execute well on the strategic priorities that we previously outlined, which is helping us deal with the crisis at hand while, at the same time, delivering long-term value for our shareholders.

First, we continue to make great progress on integration despite the environment. Our team delivered \$55 million in net synergies in Q1 from improvements in benefits and overhead costs, and we now expect to achieve \$165 million of incremental net savings in 2020, up versus our previous expectation of \$115 million as we accelerate savings and manage through the pandemic. And there's no change to achieving \$300 million in cumulative net savings or about \$500 million gross in 2021, which, as we've announced before, is about 1 year ahead of schedule.

Second, we continue to drive a culture of operational excellence deep into the company to improve quality and productivity and expand margins. This was evident in our first quarter results where we built upon last year's performance and delivered E3 savings on top of synergies to offset mix headwinds. For the year, the combination of cost synergies and E3 savings allow us to increase full year margin by 25 basis points to 17.5% at the midpoint despite the cost-absorption challenge from revenue headwinds and the expenses being incurred to fight the pandemic. And on working capital, we continue on the improvement trajectory from the stub year with another 2-day operational reduction since year-end and about 10 days operationally since the merger closed, primarily from better inventory management. We believe we have the tools and proper focus to manage in the current environment, leaving the path to 50 days of working capital intact for 2022.

Third is to invest in technology and innovation in anticipation of customer needs to grow revenue in the long run, and we expect to sustain our industry-leading spend on R&D despite the pandemic. The team is making terrific progress in improving the efficiency and effectiveness of our



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investments, creating room in our budget to support investment in the growing pipeline of revenue synergy opportunities. We have now submitted 41 revenue synergy proposals, up 18 from last quarter, with another 3 down selects out of 8 in the first quarter, primarily related to classified work in our Space and Aviation Systems segments. To date, we've been down selected on half of the 16 proposals awarded with orders booked in the tens of millions and a lifetime revenue potential of over \$2 billion.

Our fourth priority is reshaping the portfolio to focus on high-margin, high-growth and technology-differentiated businesses, and this has not changed. So far, we've announced 3 transactions representing about 3% of revenue that will result in about \$1 billion in proceeds. Our airport security and automation business, the largest of these announcements, closed yesterday with 2 smaller ones closing later this month and by midyear, neither of which have a financing contingency. We're still targeting divestitures in the range of 8% to 10% of revenue, including the divestitures announced to date. And while the timing is now more fluid, we continue to have active discussions and are committed to maximizing value.

And then finally, our fifth priority is to maximize cash flow and sustainably grow free cash flow per share. We're maintaining our adjusted free cash flow guide for 2020 at \$2.6 billion to \$2.7 billion and remain on track to achieve \$3 billion in 2022. In the quarter, we generated over \$500 million in free cash flow and returned \$883 million to shareholders, including \$700 million in buybacks and dividends which were increased 13% in the quarter. For the year, we have now assumed \$1.7 billion in share repurchases, including the proceeds from divestitures, which leaves us with plenty of liquidity given the environment.

Moving to 2020 guidance. We expect organic revenue growth of 3% to 5% versus the prior 5% to 7% as we consider risks related to our commercial aerospace, international and public safety businesses due to the pandemic. On margins, again, we are expanding guidance at the upper end and narrowing the range to 17.4% to 17.6%. And we expect earnings per share of \$11.15 to \$11.55 with our free cash flow outlook unchanged.

Overall, I'm proud of the dedication of L3Harris employees and their commitment to the mission at hand, and I'm confident in our ability to proactively manage risk so we can navigate these unprecedented times.

So with that, let me turn it over to Chris to provide an update on our operations and segment performance.

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**Christopher E. Kubasik** - *L3Harris Technologies, Inc. - Vice Chairman, President & COO*

Okay. Thank you, Bill, and good morning, everyone. I'll start with what we're doing from an operational standpoint to mitigate business risk due to COVID-19, then shift to our operating performance and results. The management team has taken measures to ensure the safety of our employees at our over 100 facilities. We've modified the work space, especially in areas with high capacity such as our production floors in Rochester, New York and Clifton, New Jersey to either create space for individuals between workstations or to install partitions when social distancing is impossible. In addition, we've adjusted our work schedules by implementing multiple shifts or staggered shifts across our company. And at several of our locations that have higher risk, we have already implemented temperature checks and health screening before employees enter buildings. We've provided PPE to employees, eliminating travel and taking other recommended precautions. The environment changes daily, and these safety protocols are mitigating risk and continue to limit disruption for our company.

Turning to supply chain. We're managing risk daily with cross-company crisis teams established to assess and develop mitigation plans where needed. We've provided essential certification letters to all of our key suppliers globally and continue to engage in active dialogue and analysis to identify areas of vulnerability. With the recent changes by the DoD around its progress payment policy, we expect to flow down in excess of \$100 million of cash to help small businesses during these unprecedented times. As of today, we've advanced approximately \$80 million and expect to exceed \$100 million this week.

Now turning to quarterly segment results on Slide 6. Integrated Mission Systems grew revenue 1% from a ramp in our maritime business on classified programs, partially offset by timing in electro optical and ISR following double-digit performance last year. Order momentum was broad-based with a funded book-to-bill above 1.0 in every IMS sector during the quarter, resulting in the overall segment at 1.37 for the quarter and 1.09 since the merger. One highlight was over \$800 million in award activity from our leading position on the big Safari programs. First quarter operating income was up 22%, and margin expanded 260 basis points to 14.7% from operational excellence and integration benefits.



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On Slide 7, Space and Airborne Systems revenue increased 7% in the quarter. This solid performance was driven by a production ramp and increased content on the F-35 platform as well as growth on classified programs in Intel and Cyber. Funded book-to-bill was 1.16 for the quarter and about 1.0 since the merger. In the quarter, we secured our position as a prime mission integrator for our nation's space domain awareness program called MOSSAIC. This award, if fully exercised, has the potential to reach \$2 billion. Segment operating income was up 12%. And margin expanded 70 basis points to 18.5% driven by strong program execution and integration benefits.

On Slide 8, Communication Systems revenue was up 5% for the quarter as DoD tactical benefited from modernization demand that supported weekly deliveries of the 2-channel multiband radio increasing by 50% sequentially. Additionally, solid growth in broadband communications partially offset by timing of sales in international tactical and prior year strength in public safety factored into the growth rate. Funded book-to-bill has a slight downshift to 0.8 in the quarter due to timing, though it's been solid at 1.03 since the merger. Key awards included a \$383 million sole source IDIQ from the U.S. Marines for next-generation HF radio systems as part of a multiyear modernization effort and an IDIQ for \$500 million from the U.S. space force to provide secure anti-jam satellite communications for the A3M program.

Segment operating income was up 11%, and margins expanded 120 basis points to 22.9% in the quarter from integration benefits and strong operational performance, partially offset by the mix impact from the ramp in tactical radio modernization programs.

Lastly, on Slide 9, Aviation Systems revenue grew 11% in the quarter, driven by our defense businesses. Orders outpaced sales on the defense side leading to a funded segment book-to-bill of 1.05 for the quarter and 1.09 since the merger. Segment operating income was up 40%, and margins expanded 300 basis points to 14.5% from improved operational efficiencies and integration benefits.

Looking ahead, we expect the headwinds on the commercial side to pick up. As a result, we've taken a number of measures to improve the cost structure based on the market conditions. The downturn has also been a triggering event that led to over \$300 million of noncash impairments for goodwill and other assets of the segment. We're committed to supporting our employees, our supply base and our customers to ensure we get through this together.

With that, I'll turn it over to Jay.

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**Jesus Malave - L3Harris Technologies, Inc. - Senior VP & CFO**

Thank you, Chris. I'll begin with a quick recap of first quarter results before discussing our revised outlook and liquidity position. Revenue was up 5%, and EBIT increased 17% leading to EPS growth of 21%. We have solid margin expansion of 170 basis points to 17.5% primarily from integration savings and pension benefits. Free cash flow for the quarter was \$533 million, and we ended the period with 62 days in working capital before purchase accounting adjustments. Overall, solid results in the face of a tough compare and a deteriorating backdrop.

Okay. Let's now turn to the 2020 outlook on Slide 10, and I'll provide more color on our updated guidance. Starting with the top line. Organic revenue is now expected to be up 3% to 5% versus our original guidance of up 5% to 7%. About 2/3 of this comes from resetting expectations for our commercial aerospace businesses due to COVID-19 and its impact on the macro environment. When adjusting for the sale of airport security and automation, the remaining business generated about \$800 million in sales in 2019 tied to commercial aerospace through training and avionics equipment.

Commercial training represents roughly 40% of the sales and includes the manufacturing of simulators and training of new pilots as well as those of airlines. And within avionics, we manufacture and service a number of components including collision avoidance systems, transponders as well as voice and data recorders. These businesses are tied to broader aviation trends including air traffic, airline profitability and OEM production rates, which are all under pressure.

For instance, IATA has forecasted traffic to be down nearly 50% for the year. As a result, our guidance now reflects approximately \$500 million in revenues or a reduction of about half of the sales for the remainder over the year when compared to 2019. In addition, we factored in pressures at our Public Safety Radios business, which in 2019 had \$500 million in sales. This business is focused on state and local municipalities in North America,



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which are facing budget and operational constraints due to the pandemic leading to an over 10% decline relative to our prior expectation of low single-digit growth.

Finally, on the international front, which comprises roughly 20% of our sales, we are now assuming a more flattish outlook versus an increase in the low to mid-single digits previously. In contrast, we expect higher revenues from our DoD businesses including tactical radios and ISR.

On our margin outlook, Bill talked about the acceleration of integration and productivity benefits that drive a 25 basis points increase in our margin guide to 17.5%, putting us at the upper end of the prior range. And that's net of approximately 30 basis points of headwinds associated with fixed cost absorption from volume declines that we've offset with expense reductions.

Bringing this down to our full year EPS, we now see \$11.15 to \$11.55 or \$11.35 at the midpoint, down \$0.20 as compared to our prior guide, midpoint. The range is premised on 217 million shares inclusive of the \$1.7 billion in share buybacks noted earlier and a 17% tax rate.

And bridging EPS to our prior guide on Slide 12, we have a \$0.15 in headwinds from the timing of divestitures and repurchases, while the \$0.52 in COVID-related headwinds are nearly offset by incremental synergies and improved performance from midpoint to midpoint.

Finally, a quick note on the profile of EPS for the remainder of the year. We expect the pandemic related impact to be most notable in the second quarter with stronger growth anticipated in the second half.

Moving to free cash flow, our guide of \$2.6 billion to \$2.7 billion is intact, and so is the multiyear outlook. For this year, our cash flow is bolstered by accelerated synergies, federal stimulus and cost takeout, which will offset the reduced revenues discussed earlier. In our working capital, we'll also look to manage the environment, so our 3-day goal of improvement in 2020 remains in place as well.

Moving over to liquidity. As Bill noted earlier, we remain in a strong position. We ended the first quarter with over \$400 million of cash in hand, net of the April debt maturity, and a \$2 billion untapped credit revolver. When looking ahead to the end of the second quarter, our liquidity should reach over \$3.5 billion post divestitures, which would include at least \$1.5 billion in cash and full access to the revolver. Also, our next debt maturity of \$650 million isn't due until early 2021, and our balance sheet is healthy at 2x leverage.

Now switching to the segment outlook. We've narrowed our integrated Mission Systems revenue range to be up 5.5% to 7% versus the prior 5% to 7% guidance, driven primarily by strength in our ISR business. Segment operating margin is projected to be about 13.5% or a 25 basis point increase from the previous midpoint, reflecting performance to date and increased synergy benefits.

In Space and Airborne Systems, we've also narrowed our revenue range to 6% to 7.5% growth driven by modernization and sustainment on the F-35 platform in Mission Avionics. Segment operating margin is expected to be 18.75% and is unchanged at the midpoint. Communication Systems revenue is now expected to be up between 3.5% to 5% versus the prior guide of 6.5% to 8.5%. This reflects headwinds in our public safety business of about 1.5 points and a reduction of international volumes in tactical radios and integrated vision. Segment operating margin is anticipated to be about 23.75%. That's up 100 basis points relative to the prior midpoint, reflecting increased cost and integration benefits. And finally, in aviation Systems, we are forecasting an organic revenue decline of 1% to 5% year-over-year primarily from the factors I noted earlier in commercial aerospace. This points to reported revenues of approximately \$3.4 billion to \$3.6 billion for the year post divestitures.

On the commercial side, revenues are set to be down around 35% organically for the year. And for our government-related businesses, which include mission networks, military training and defense aviation products, they are expected to be up in the mid- to high single digits. Segment operating margins are expected to be approximately 13.25%, down versus the prior guide by 75 basis points from the midpoint due primarily to fixed cost absorption from the volume declines, partially offset by cost actions. The margin guide also accounts for the airport security and automation divestiture we closed yesterday.

So to summarize and put it all together, overall, a pullback in our outlook, but one where the pandemic-related impacts have been nearly offset by management actions with the remainder being the result of a more flexible approach to capital deployment in this environment.

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With that, I'll ask the operator to open the line for questions.

## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) We will go first to Carter Copeland with Melius Research.

### **Carter Copeland** - *Melius Research LLC - Founding Partner, President and Research Analyst of Aerospace & Defense*

I trust everyone's well. Just a quick clarification and a question. I wondered, Jay, if you could give us a little bit more color on the cash bridge on the guidance for all the moving pieces with AS and tax and suppliers and progress payments and synergies. I think that would help everyone.

And just bigger picture, Bill or Chris, with respect to how the business -- the combined business is evolving, I mean, you highlighted the synergy opportunities, the revenue synergy opportunities, you look at that opportunity pipeline, you look at what the business is going to look like in the wake of COVID-19, how does all of this influence your thoughts on portfolio and shaping and whatnot? Any updated thoughts there would be great.

### **Jesus Malave** - *L3Harris Technologies, Inc. - Senior VP & CFO*

Sure, Carter. Let me start with the free cash flow. As we mentioned earlier in the prepared remarks, we have the benefit of the progress payments going from 80% to 90%. It's an excess of around \$100 million that's being flowed down to the suppliers. And so net-net, that's a very little impact. There is a benefit on stimulus related to taxes, which is helping us offset some of the other impacts across the business. But when you take a look at net income, that is moving. But as I mentioned in the prepared remarks as well, we've largely offset that. And so with the benefit of the stimulus efforts, we're just holding that as a placeholder. We may have to go deeper into supplier payments. We may have to think about our pension contributions and things like that. But for the most part, we've held the working capital intact up to 3 days. Net income is a little bit lower. We're getting benefits from the stimulus efforts, and we're just kind of holding that as a placeholder for other things for later in the year.

### **William M. Brown** - *L3Harris Technologies, Inc. - Executive Chairman & CEO*

And Carter, on your question on the sort of long-term outlook, look, we're very pleased with the progress of the integration so far. The cost synergies are going very, very well. We're finding great opportunities on revenue opportunities. And I think it's testament to the power of the combined portfolios as we laid out 18 months ago when we announced the merger and the areas that we could offer new mission sets to our customers. And COVID-19 notwithstanding, it's playing out as we had expected. We have much more powerful competitive offering, and it's helping us quite substantially in mitigating some of the risks that you were seeing coming through in small parts of the portfolio through the pandemic.

Now in the portfolio shaping, we've been at this now for 18 months. We've made some good progress here. We've about -- we're about 1/3 of the way through in terms of the revenue we anticipated divesting. We had sized that for investors back in early February that was pre-COVID. We keep looking at the portfolio. It's an ongoing process, but we're going to shape our decisions on what is in our portfolio based on long-term strategy, our ability to differentiate via technology, our ability to grow and win in those segments. And that hasn't changed based on the pandemic. We continue to look at that. I don't know if, Chris, if you wanted to maybe augment that.

### **Christopher E. Kubasik** - *L3Harris Technologies, Inc. - Vice Chairman, President & COO*

Yes, Carter, I'll just chime in that when I look at our new business opportunities and some of the things we're currently working on, I continue to believe our portfolio is well aligned with our customers' focus and desire. You hear a lot about multifunction systems, which we are currently

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implementing in space. We are submitting white papers on ABMS and, of course, the Navy is coming out with an offering or an RFP on spectral. So I think we're well aligned there on the capability front. And then the modular open system architecture, I think the F-35 is a good example of those capabilities. So I think it positions us well for the long term.

**Operator**

Our next question comes from David Strauss with Barclays.

**David Egon Strauss** - *Barclays Bank PLC, Research Division - Research Analyst*

So, Bill, just wanted to ask on working capital progress. It doesn't sound like the progress payment change benefited you at all in Q1, but you got 2 days of sequential improvement. I think you had talked about that in Q1, you might have given back some of the upside that you saw in early collections in Q4. And so maybe just comment on that. And I think from here, you're only assuming about 1 day of additional working capital improvement through the rest of the year.

**William M. Brown** - *L3Harris Technologies, Inc. - Executive Chairman & CEO*

Yes, David. That's all factual. Prog pay did really benefit us in the first quarter. It's really just starting now in some ways. It's not a big part of our portfolio. It's only about 7% of our revenue, so you're not going to see big numbers. And as Jay and others and Chris pointed out, what we're receiving from the government through progress payment acceleration, we're flowing that out to the supplier base. So that, net-net, won't be a factor in the year.

So we're making good progress. So 2 days, sequentially, 10 days operationally since the beginning of when we closed on the merger. It's -- I think it's just fantastic work that the team has done. A lot of it is coming out of inventory. We're seeing some opportunities elsewhere. We have a lot of inventory coming out as we've been pointing out to investors for some time. We're expecting maybe another day towards the balance of the year. There's some purchase accounting opportunities here, if you will, in the year. So we'll end this year below 60, probably in the 58-day range. And as we look out the next couple of years, again, 3 to 4 days per year in '21, 3 to 4 days in '22. So we see ourselves around 50 days of working capital by the time we get out into 2022, which, as you know, is still about 5 days higher than our peers were at the end of '19 and about 10 days higher than where Harris was before we closed on the transaction. So we still see some good opportunities to continue to drive working capital performance beyond '22.

**Operator**

Our next question comes from Robert Stallard of Vertical Research.

**Robert Alan Stallard** - *Vertical Research Partners, LLC - Partner*

On the adjustment to the aviation guidance for the year, I was wondering if you could elaborate on whether this has resulted from the order intake or the conversations with your customers, or whether it is a best estimate at this stage. It is relatively early days.

And in relation to that, Chris, I was wondering if you could comment on what sort of flexibility you have to reallocate cost or capacity in the aerospace business to defense or elsewhere?





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**William M. Brown** - *L3Harris Technologies, Inc. - Executive Chairman & CEO*

So, Rob, really on both. I mean Jay went through the details, I think, pretty carefully in his script. So it's a business that was \$800 million, it's going down to \$500 million, so down 40%. We talked about the components, to be very clear. Training is about 40%. And effectively, what -- in net debt, we see being down 40%, 45% for the year. But effectively, what we've done is that we won't sell any new full flight simulators beyond Q1. So we sort of zeroed that out. That could be conservative, but that's what we've assumed so far. It is through conversations with the airlines, with OEMS. It's a pretty detailed bottoms-up analysis that the team has done and really has worked on over the last 4 to 6 weeks. I think we've done a good job on that. 60% of the businesses is avionics. We see that business down for the year around 30%, but it's got several components. There's a commercial OE and aftermarket component of that. Obviously, that's going to be down substantially based on line rates we're hearing from Airbus and Boeing, based on IATA data, on RPK. There's a piece of it that provides military avionics, in other words, provides avionics on a commercial platform that has a military end use. That's relatively stable, which is why avionics isn't being hit quite as much as you might expect.

So for the year, we've got quite a bit of the back end of the year in backlog. We're watching it very, very carefully, watching order intake rates. And we think based on what we see today, we've sized it appropriately again. But it's a very, very volatile environment, and we're watching it very closely. And I'll let maybe Chris talk about some of the shifts that are happening in the workforce.

**Christopher E. Kubasik** - *L3Harris Technologies, Inc. - Vice Chairman, President & COO*

Yes. Robert, we've taken the actions in commercial aviation to reduce the cost with the operating expense maybe down \$20 million for the remainder of the year. And we've been pretty aggressive with reductions in force and furloughs. But to your question, specifically on the engineering front, as of today, we have over 50 engineers that were working on the avionics products that have been redeployed to DoD work. And now that we're all learning how to work remotely and a little more creatively, not many of those individuals needed to relocate. So I think it's a good story relative to the engineering talent.

**Operator**

Our next question comes from Gautam Khanna with Cowen.

**Gautam J. Khanna** - *Cowen and Company, LLC, Research Division - MD & Senior Analyst*

Just a couple questions. First, on communication systems. I was wondering in the revised guidance, sort of what's the anticipated foreign tactical RF change relative to what the prior was. And at PSPC, how much of a lingering drag beyond 2020 do you anticipate seeing as a result of the recession?

**William M. Brown** - *L3Harris Technologies, Inc. - Executive Chairman & CEO*

So, Gautam, I'll maybe touch on both of those pieces. So overall, tactical, we had, I think, a pretty good start to the year. We're up 12%. So DoD was really strong. International was down mid-teens and pretty close to what we had expected. It will be down in that same range in the second quarter as well, recovering in the back half. You'll start to see a little softer year-over-year growth in DoD simply because of the tough compare. So now what we see international to be is roughly flat for the year. Before, we thought it would be up low to mid-single digits, so call that 3%. So now about flat. In that flatness, we still see the APAC, or Asia Pacific region, up low double digits. Central Asia, up significantly because of Afghanistan and some of the drawdown that's happening there. We still see Middle East, Africa to be up low single digits, but that has come down from the last guidance. Europe will be down mid-single digits. We know Western Europe is getting a little bit better. Eastern Europe is still going to be down. And then that's really -- those are really the bigger pieces here. Central America is roughly flat, and Canada is going to be down as we had expected in the year. So overall, we still see DoD being up, in fact, a little bit better, up low to mid-teens, around 14%, and now we see international being about flat.

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On public safety, we've had a very good run here. The last 6 to 8 quarters have been very, very strong, has been growing. Last year was close to 20% growth. Margins were coming up. We've got a great product line, better quality, really good execution. So we felt very good about that. This year, we're guiding to low single digits, which is in line with the LMR growth rate in North America, as Jay pointed out, down more than 10 points from that, so call that down 10%. So it's about \$60 -- \$50 million, \$60 million of revenue erosion. We'll see that pretty prominently here in the second quarter. And probably you'll see it about the same through the balance of the year. It's going to be a pretty tough back end of the year for public safety.

I think beyond 2020, it depends on what happens to the economy state and local tax revenues. Right now we're fighting in Q2, not just a revenue impact but just the fact that you have the states and localities dealing with COVID and not able to work, doing an installed system that's public safety. So we're hopeful it could get a little bit better in '21. But it's too soon to say that, Gautam.

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**Gautam J. Khanna** - *Cowen and Company, LLC, Research Division - MD & Senior Analyst*

Okay. No, that's a very helpful overview. And then just -- maybe I missed it, but the integration -- integrated vision systems. What's going on there in terms of decline? Maybe I misheard you in the opening remarks. But what sort of -- what changed?

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**William M. Brown** - *L3Harris Technologies, Inc. - Executive Chairman & CEO*

You're talking about IMS, the Integrated Mission Systems business?

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**Jesus Malave** - *L3Harris Technologies, Inc. - Senior VP & CFO*

Integrated vision.

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**William M. Brown** - *L3Harris Technologies, Inc. - Executive Chairman & CEO*

Integrated vision. The night vision business?

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**Gautam J. Khanna** - *Cowen and Company, LLC, Research Division - MD & Senior Analyst*

So integrated vision systems. I'm sorry, not IMS, the segment.

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**Christopher E. Kubasik** - *L3Harris Technologies, Inc. - Vice Chairman, President & COO*

Okay. Yes, integrated vision systems is performing well on the ENVG program. We're meeting our delivery schedules and looking forward to additional opportunities later in the year. That's more domestically. I think the question is probably related to some of the opportunities we have in the Mid East, and we talked about more conservatism in the Mid East. We have not had any cancellations. What we're seeing are delays or hold ups. And I think a lot of that just ties to the several factors. The export approval process, including congressional notification, is a whole new process, and it's all being done remotely and virtually. And some of our international customers are working remotely. Some have closed their ministries, and some actually have curfews in place. So we just see all those items contributing to more of a timing issue. So we reduced the outlook there, if that helps.

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**William M. Brown** - *L3Harris Technologies, Inc. - Executive Chairman & CEO*

But still up low to mid-single digits in night vision for the year.



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**Gautam J. Khanna** - Cowen and Company, LLC, Research Division - MD & Senior Analyst

Okay. And that will compare to what was the prior?

**William M. Brown** - L3Harris Technologies, Inc. - Executive Chairman & CEO

It was in the low double digits.

**Operator**

Our next question is Doug Harned with Alliance Bernstein.

**Douglas Stuart Harned** - Sanford C. Bernstein & Co., LLC., Research Division - SVP and Senior Analyst

When you talk about the synergies, you're ahead of plan, \$165 million net synergies for 2020. And you've had the -- and you've also had, I would assume, some impediments from COVID-19. I mean, this seems like awfully good progress. I mean how -- does this give you more optimism when you look at that \$300 million net synergy total overall? And I'd say that from 2 things. One is you're ahead of plan here but also, you're ahead of plan, and perhaps you could have even done better had you not had the COVID-19 issues.

**William M. Brown** - L3Harris Technologies, Inc. - Executive Chairman & CEO

Yes. We're making really good progress here, Doug. Look, we did move forward the \$500 million -- \$300 million, \$300 million net, which we expected in calendar '22 to calendar '21. So we're not going to be done at the end of '21. We're going to continue to be working this into 2022. And it will become part of the normal operations. So we do expect that the ultimate synergy value coming out of this merger is going to be beyond the \$500 million and \$300 million we've talked about previously because we're seeing it already. It's coming forward, and it's likely to go up.

So we had \$65 million in a stub year. We started out of the gate very, very quickly. I wouldn't say it was conservatism coming into this year, but we were still a fairly new company. There were a lot of moving parts in the year. We guided to an incremental \$115 million in net synergies earlier this year that's getting quite a bit better, more visibility that we're seeing right now in indirect spend. We've seen the consolidation of all of our benefits programs now being completely implemented. All of the CHQ and segment consolidations are now essentially done. We're just seeing just better progress.

So is there any impact from COVID? It's probably on the fringes. There are going to be some issues that we might have that are already embedded in this number that we're talking about here, Doug. Some of the opportunities are really supply chain related. They may slip out a little bit. But we feel very good about the trajectory we happen to be on. We've got a very seasoned integration team, people that know how to work and drive their jobs and are doing a great job remotely. So we feel good about this. And if anything, we have maybe a little more opportunity in the year as opposed to risk.

**Operator**

Our next question is Noah Poponak with Goldman Sachs.

**Noah Poponak** - Goldman Sachs Group Inc., Research Division - Equity Analyst

Bill, just trying to rethink through the 2022 \$3 billion free cash flow target as we all do every quarter. And at 1 point, it looked pretty conservative. It's now taken the hit of -- if you're going to divest 8% to 10% of the revenues and then if there's still aerospace coronavirus impacts that far out.



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But you're reiterating 2020 with the business sold to Leidos out of the free cash flow and then the reset aerospace businesses and then the \$3 billion is kind of 5% or 6% growth each of the next 2 years. So I guess, one, just kind of high level, do you still view that number as having some conservatism in it? Or is it just sort of hanging on despite the hits that it's taken? And specifically in the aerospace businesses, do those need to recover by then to get to the \$3 billion? Or can they actually just walk along the bottom and you can still get to the \$3 billion?

**Jesus Malave** - L3Harris Technologies, Inc. - Senior VP & CFO

Well, let me start. No. Again, \$3 billion, as Bill mentioned, is premised on us being able to continue to get improvement in the working capital to around the 50 days. We still see, in spite of the business where we -- where things are today, the path to be able to deliver that. We've identified the opportunities and a lot of that, as Bill mentioned, is sitting in inventory. And a lot of those benefits weren't necessarily pegged to the commercial business. There's some of it that was there. And yes, we'll see it, the lower cash flow projection than we otherwise would have before the would have before the COVID-19 in commercial. But we have the runway and working capital to be able to do that. As Bill mentioned, we see the path. It's not going to -- it's certainly going to be more challenging than it was before. But I wouldn't characterize it as hanging on. I would say that perhaps our buffer, our cushion is a little bit lower than it was before, but the path is still very clear to us.

**Noah Poponak** - Goldman Sachs Group Inc., Research Division - Equity Analyst

Okay. And Jay, just as a quick follow-up on the free cash flow, any ability to articulate to us what the ongoing seasonality through the year should be? Because if I remember correctly, you had discussed pulling some forward into the fourth quarter of 2019, but then the first quarter of 2020 is better than expected. I know you have some -- I know there's a lot of moving pieces in there, but should the free cash flow through the years going forward be relatively level loaded? Or should it be a pretty steep ramp through the year?

**Jesus Malave** - L3Harris Technologies, Inc. - Senior VP & CFO

It's probably somewhere a mix between the two. It's been kind of back-end loaded over the past number of years. I would say, in 2019, even 2019 was a little bit more level loaded. This year, \$533 million are pretty consistent with what we did for the companies combined last year. And so our goal is to make it more linear throughout the year, but I think there's just some -- there is some natural level of linearity in there where it will probably be still a little bit more back-end loaded there. So yes, it will still probably stay a little back-end loaded but again, a lot better than it's been historically. In 2019, I think, was the start of that.

**Operator**

Our next question, Sheila Kahyaoglu with Jefferies.

**Sheila Karin Kahyaoglu** - Jefferies LLC, Research Division - Equity Analyst

Bill, growth is muted in 2020 at 3% to 5% organic. And just from what we've become accustomed to, I understand aviation is 2 points of that headwind. I guess how do we think about some of the revenue capture opportunities and timing, whether it's the 41 proposals you mentioned and the 3 incremental down-selects this quarter and -- or how the core business just reaccelerates in '20 and '21?

**William M. Brown** - L3Harris Technologies, Inc. - Executive Chairman & CEO

Sheila, thanks so much for the question. The revenue synergies are going to be rolling out over the next probably 12 to 18 months. As I mentioned in my prepared remarks, orders are in the tens of millions. They could grow more substantial in '21 and '22. They require -- were down select. They have to be then finally awarded, and they start to build in time, again, 1.5 years out or so. So yes, we're down -- we're at 3% to 5% this year.



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The defense business remains very good for us. It's up around 8%. International, as Jay mentioned, we're flattish. But the commercial part of the portfolio, which is aerospace, public safety, is going to be down more than 20%. So the defense piece, the core defense part of the organization is very healthy. It's high single digits. And as we look out in the next year, we've got -- we see good bookings this year. We see a very good pipeline, about \$64 billion of pipeline of opportunities. It's up about 8% since we closed on the merger. We have revenue synergy opportunities that are starting to kick in. So I see us getting back in '21, '22 to more in that mid-single-digit range. We -- let's see how the next 9 months play out this year and what happens with the COVID pandemic but -- and the budget process beyond '21, but I think things should recover. And we'll be in pretty good shape beyond this year.

**Operator**

Our next question is Seth Seifman with JPMorgan. Sorry, we've lost his line. We'll move to Jon Raviv with Citi.

**Jonathan Phaff Raviv** - Citigroup Inc, Research Division - VP & Analyst

Bill and Jay, can you talk about capital allocation? I do certainly appreciate the message around growing free cash flow per share and how repurchases is a big tool for you guys, but can you address can you address that tool in an environment where potentially the norm could move against repurchases? What else could you do with cash in that kind of dynamic?

**William M. Brown** - L3Harris Technologies, Inc. - Executive Chairman & CEO

Well, look, I mean, for -- at the moment, Jon, I mean, our overall philosophy on capital deployment really hasn't changed. We're going to drive and generate substantial free cash. We're going to pay an attractive dividend that has a payout ratio in the 30%, 35% range. You saw back in February, we raised the dividend by 13% -- 10% back in August last year. So we continue to be committed to paying an attractive dividend. We don't have -- our leverage ratio, as Jay pointed out, is pretty attractive. Anything debt that's coming due will likely be refinanced, so that won't be a pull on cash. We don't see pension contribution for probably another year or 2, depending upon what happens in rates and returns this year. So it does leave a lot of capacity for deployment. And at the moment, we're still committed to returning that to shareowners in the form of repurchases. I had mentioned in my remarks, for the year, we're going to be at \$1.7 billion. So we'll return the \$1 billion in proceeds from selling STS. Beyond that, we'll pause it. But we'll have a tremendous amount of capacity at the back end of the year, lot of liquidity. And I see this sort of normalizing as we get into calendar '21.

**Operator**

Our next question, Ron Epstein with Bank of America.

**Ronald Jay Epstein** - BofA Merrill Lynch, Research Division - Industry Analyst

Can you -- you mentioned the \$64 billion of opportunities now with the joint company. Could you talk about some of those that are more near term, things we can keep an eye on to keep score on how you're doing relative to those \$64 billion of opportunities?

**Christopher E. Kubasik** - L3Harris Technologies, Inc. - Vice Chairman, President & COO

Ron, it's Chris. We have several opportunities that I think are a little more significant you can track later in the third quarter. The current plan is for the next-gen Jammer contract to be awarded a competitive opportunity. I think that will be interesting to watch. We've talked a lot about our responsive satellites. We've been getting orders and continue to get orders on those satellites. So you can track that.



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On the ISR front, we've talked a lot about the paradigm program in Australia that will have follow-on opportunities, but we also have comparable opportunities in Italy and elsewhere around the world. The EW capabilities, Bahrain, UAE comes to mind. Clearly, the tactical radios, we have a fair amount to go here in 2020. And then even on the international front, we're on the maritime team with a variety of OEMs and shipbuilders from Romania to Taiwan to Australia, so you'll be able to track those -- highlight those as a couple to follow Ron.

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**Ronald Jay Epstein** - *BofA Merrill Lynch, Research Division - Industry Analyst*

And if I may, just a follow-on quickly. Do you guys have a position on the frigate program that was just awarded to mechanical? Or not the mechanic, the FFG(X).

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**Christopher E. Kubasik** - *L3Harris Technologies, Inc. - Vice Chairman, President & COO*

Yes. Yes.

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**William M. Brown** - *L3Harris Technologies, Inc. - Executive Chairman & CEO*

Fincantieri. Yes. Fincantieri.

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**Ronald Jay Epstein** - *BofA Merrill Lynch, Research Division - Industry Analyst*

Fincantieri. Yes.

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**Christopher E. Kubasik** - *L3Harris Technologies, Inc. - Vice Chairman, President & COO*

Yes. Yes. Great question. We have -- there were 4 bids. And given our capabilities, we were on all 4 of the teams. So as you would imagine, I think we're well positioned with Fincantieri Marinette Marine. And more to come on that. Usually, they pick the frigate first and then the second-tier suppliers are negotiated and competed. But we feel very comfortable with our capabilities and being able to participate on that program.

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**Ronald Jay Epstein** - *BofA Merrill Lynch, Research Division - Industry Analyst*

Okay. Great. Yes. Fincantieri. Yes. Sorry about that. It was my error.

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**Christopher E. Kubasik** - *L3Harris Technologies, Inc. - Vice Chairman, President & COO*

Thank you.

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**Operator**

Our next question is Peter Arment with Baird.

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**Peter J. Arment** - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Bill, you gave us some color on the international, just flat for this year. I mean what kind of visibility do you have or conversations with your customers? I know Chris mentioned that there's some export offices are closed or some customers are even closed. Just thinking about growth as we exit a COVID-19 worldwide, what kind of bookings do you need to see in the second half of this year?



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**William M. Brown** - *L3Harris Technologies, Inc. - Executive Chairman & CEO*

Well, as we said, we think the revenue in international will be roughly flat this year. So clearly, booking some of the orders that are important in the back half will require engagement with customers. It's happening today via phone, but we're going to have to sort of start to see an ability to see customers, demonstrate product, sign contracts, and that's going to require some face-to-face conversations.

So there's been a lot of dialogue happening right now. We're trying to get a sense for the timing of some of the opportunity we have in the back end of the year. We think it was appropriate given some of the short-term nature of the opportunities in tactical, electrooptical to pull that out, is which will be done here to recalibrate international for the year. But as this thing starts to open up, we've got a pretty good team internationally, and we're -- they're out there meeting with their customers, talking to their customers. And we'll see as we get towards the back end of the year how the orders flow through.

**Peter J. Arment** - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Okay. If I -- just a quick follow-up. Chris, is there any incoming on from WESCAM regarding just from a demography perspective, just an opportunity in the COVID-19 world?

**Christopher E. Kubasik** - *L3Harris Technologies, Inc. - Vice Chairman, President & COO*

Yes. No, the WESCAM business is doing quite well. I think if you're referring to doing some sort of thermal imaging or such, it's really not at that price point. It's better sticking with their core market and focused on the airborne assets. So...

**Operator**

So our next question comes from Pete Skibitski at Alembic Global.

**Peter John Skibitski** - *Alembic Global Advisors - Research Analyst*

Bill, something I've been curious about kind of top-level is this topic of 5G. And I know it's obviously kind of a commercial standard, but I've also seen you mentioned that DoD is running some pilot projects related to 5G as well. So I'm just curious if you can give us your thoughts from a top level on whether or not this impacts L3Harris in any way, kind of and/or if you feel like it's a technology you need to be involved in developing or in some other way?

**William M. Brown** - *L3Harris Technologies, Inc. - Executive Chairman & CEO*

Yes. Pete, look, it's a good question. I won't be able to give you a complete fulsome answer on this. But we've had -- we have an internal team focused on 5G. We're not an inventor, but we certainly have applications that are using 5G technology. So we do play in the space. We need to be present in the area. We need to find a DoD or defense-related applications of 5G. It's going to affect war fighter effectiveness. So we do have specific activities here. I wouldn't say it's a big driver this year. But certainly, over time, it's a core capability that we need to have as a leader in spectrum superiority. So clearly, Pete, that's -- it's something that is central to our strategy over the next several years.

**Operator**

Our next question, Myles Walton with UBS.



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**Myles Alexander Walton** - *UBS Investment Bank, Research Division - MD & Senior Analyst*

Maybe, Bill, in addition to the higher-progress payments, the DoD seems to be also bidding pretty aggressive on pulling forward contract awards and getting kind of the money out of the hands of the DoD and obligating that as quick as they can. I'm just curious, did you see that in the quarter, obviously, good bookings at SAS and IMS? Or is that something that might help bookings continue to be strong in the second and third quarter?

**William M. Brown** - *L3Harris Technologies, Inc. - Executive Chairman & CEO*

Look, Myles, it's a good question. Credit due to the folks in DoD, really across the services. We've had very active dialogue, both Chris and I and some others on the team with a lot of leaders across DoD and across the services, and they've been very aggressive, not just on prog pay but accelerating awards. You probably have heard Hondo in the -- at the Navy accelerating quite substantially awards. So we did see some opportunities move left, some out of Q2 into Q1, some out of the back half of the year into the front half.

Chris mentioned A3M. That's an opportunity. We saw an acceleration of an opportunity in IMS, the Virginia Amp. So we did see some opportunities moving left. And I think that we'll continue to see that. It's -- DoD is really focused on this. We're trying to put money on contract that we then quickly then put suppliers on contracts. So we keep, not just cash flowing but opportunities flowing into the supply base, so certainly something we're all focused on.

**Peter John Skibitski** - *Alembic Global Advisors - Research Analyst*

Okay. And clarification, Jay, on the slide on the block of EPS. There's pension called out under operations, another \$0.28. How much of that \$0.28 is pension?

**Jesus Malave** - *L3Harris Technologies, Inc. - Senior VP & CFO*

About \$0.10 of -- in that \$0.28. There's a lot of moving parts in there, but pension is incremental about \$25 million.

**Operator**

We'll go next to Michael Ciarmoli with SunTrust.

**Michael Frank Ciarmoli** - *SunTrust Robinson Humphrey, Inc., Research Division - Research Analyst*

Just as -- I guess as you guys are thinking about COVID-related impacts, disruptions, any other color that you have on your broader supply chain? I mean you guys are pretty technology-driven. I'm sure there's a lot of smaller components, subsystems, discrete electronics you're procuring. Are you seeing any potential risk either from parts procured in the Asia Pacific geography? Or how are you kind of sizing that potential risk as you go forward here? Any need to build buffer stock of inventory on certain maybe at risk product lines?

**Christopher E. Kubasik** - *L3Harris Technologies, Inc. - Vice Chairman, President & COO*

Yes. Great question. This is Chris. On any given day, there's tens of millions of revenue risk. It changes on a weekly basis. We really started looking at this back in January in the Asian markets. I think we've been able to mitigate all that risk. And a lot of this depends on the countries. India shuts down. Mexico shuts down. We have to monitor those suppliers, look for second sources. But I think we're doing a real good job. We have a dedicated team focused specifically on COVID supply chain, and Bill and I get daily updates on the progress. So great question. We're trying to use predictive analysis, identify the risks and mitigate it on a regular basis.





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**Operator**

And our final question comes from Robert Spingarn with Crédit Suisse.

**Robert Michael Spingarn** - *Crédit Suisse AG, Research Division - Aerospace and Defense Analyst*

Two quick things. Bill, on the state and local budget constraints you talked about before in public safety, how do you think about how the crisis may have revealed any shortcomings in the public safety communications? And what might be the opportunity coming out of this thing?

And then I have a higher-level question. Just on budget austerity and how you and Chris think about the possibility that some -- that the budget, the defense budget at some point will be funding stimulus repayment, that sort of thing, not necessarily what we saw 10 years ago but some kind of shift in spending priorities at the federal level a couple of years down.

**William M. Brown** - *L3Harris Technologies, Inc. - Executive Chairman & CEO*

So look, really good questions. On public safety, this could drive an accelerated shift from LMR to LTE. That's been gaining some steam with FirstNet. Fortunately, we've got a radio that is LMR-LTE capable, both qualified by AT&T and Verizon. So I think we're really well positioned for that transition. I think that having a domestic supply base here is important in that particular area. We have certain technologies and applications that could allow us to open up new markets that go beyond first responders to health care providers, and we've seen that happen over the last couple of months. So the state and local finances, I think, will be impacted in the near to medium term, and we've tried to capture that in our thoughts. But it could drive an acceleration from LMR to LTE.

And relative to your question on the budget, so as you know, the '21 budget came out a couple of months ago from the President including, I think, 2% per year growth in the fight. That obviously was all pre-COVID. There's a lot of discussion happening right now between the authorizers and the appropriators of what the budget will be for '21. It was -- it came out about flattish from the President. A lot of the things that we're focused on are well funded in that, including a lot of the classified budgets look pretty good. There's \$135 billion of -- sort of, if you will, surplus investment account funding that still remains out there. It's going to provide a little bit of tailwind to us.

As you go out into '22, beyond '22 into '23, you've got an election here. Eventually, you got a \$4 trillion deficit that's going to have to be sort of paid for in some ways. But at the same time, you've got a very dangerous world. You could see what the North Koreans are doing, what the Iranians are doing, what the Chinese are doing, Russia. So we're going to continue to be tested. The threats remain there, and the investments that the DoD is trying to make are really long-term investments in technology that to sustain beyond the next couple of years. And we're hopeful that, that's -- there'll be a bipartisan alignment to make sure we continue to fund DoD. So thanks very much for that question, Rob. I appreciate that.

So thank you all for joining the call this morning. During these uncertain times, we're managing risks aggressively and taking appropriate actions to drive value for all of our shareowners. I hope we'll soon be operating under more favorable conditions. I want to close by thanking our employees for going above and beyond to support our customers and our essential missions as well as the health care workers, first responders and everyone in the frontline fighting COVID-19. Thank you all, and be safe.

**Operator**

Thank you. This concludes today's teleconference. You may disconnect your lines at this time. Thank you for your participation, and have a wonderful day.



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