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HRS - Q2 2015 Harris Corp Earnings and Acquisition of Exelis Call

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PRESENTATION

Editor

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Unknown Speaker*

Good day, ladies and gentlemen and welcome to the Harris Corporation second quarter 2015 earnings call.

(Operator Instructions) I would now like to introduce your host for today's call Ms. Pamela Padgett vice President of investor relations you may begin them

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Unknown Speaker*

Thank you.

Good morning everyone and welcome to our call to today to discuss Harrison second quarter 2015 earnings as well as our intended acquisition of Exelis that we announced earlier this morning.

I'm Palomo pageant and on the call today's Bill Brown, Chairman and CEO, Mick Lopez, senior vice President and chief financial officer, and Dave Melcher, CEO and President of Exelis.

Before we get started a few words on forward-looking statements.

In the course of this teleconference, management may make forward-looking statements including regarding the acquisition we announced today.

Forward-looking statements involve assumptions risks and uncertainties that could cause actual results to differ materially from those statements.

For more information and discussion of such assumptions risks and uncertainties pleased to the press release and filings made by Harris with the Secretary.

In addition, in our press releases and on this teleconference and the related presentation, we will discuss certain financial measures and information better non-GAAP financial measures.

Reconciliation to the comparable GAAP measures and respect of our second quarter 2015 financial results is included on the investor relations section of our website which is Www.harris.com.

A replay of the call will also be available on the investor relations section of our website and with that, Bill, I'll turn it over to.

Unknown Speaker*

Okay.

Very good thank you Pam and good morning everyone I went to start expressing our deepest condolences on behalf of Harris to the family and friends of Joe Nadol an analyst who has followed Harris for almost a decade and who tragically passed away earlier this week period so today we're announcing a transformational acquisition for Harris that will create significant and lasting value for our shareholders, our customers, and our employees.

With the acquisition of Exelis we're increasing our scale, broadening our technology-based, and expanding our customers set in markets where we had decades of successful performance period so before jumping into the transaction, Nick and I will briefly covers second quarter results and updated Harris guidance and then with dates help walk you through the acquisition before opening the call for questions.

So turning to our second quarter earnings presentation, slides 3 and 4, Harris performed well in the second quarter with earnings per share of $1.32. Operating results were solid reflected good execution and lower costs.

Earnings-per-share also benefited from lower than expected taxes, including the 2014 R&D tax credit.

Revenue for the company was down 1% with growth in Government Communications Systems, international tactical radios and commercial CapRock, more than offset by continued weakness in US tactical radios, and by the previously reported wind down of two major IT services programs. International revenue was up 5% in the quarter and was 31% of total revenue, and our strategy of expanding already strong franchises within the government market is providing revenue strength for the company period so touching briefly on the segments, Government Communications Systems posted its fifth consecutive quarter of year-over-year revenue growth and generated excellent operating income.

Demonstrating yet again the strength of its core franchises and space and intelligence avionics, air traffic management, geospatial imagery, and whether.

In the area of avionics, the F 35 program was a major revenue driver in the quarter and we also received a $60 million follow-on contract for the Albert nine.

Into traffic management where we've had a long-standing relationship with the FAA and recently expanded it with more than $900 million in awards over the last three years, we were awarded a 10 year $98 million follow-on contract for oasis to that supports flight services in Alaska, by integrating real-time weather and freight planning information.

Our strong franchise in space and intelligence have also been rich with expansion opportunities.

Classified programs where our revenue driver in the second quarter and following the close of the quarter, we had two strategic classified with us. A three-year $23 million contract from a new customer, for space situational awareness and support of Air Force missions, and a five-year $300 million single award IDIQ contract to integrate the government the various intelligence systems. In our space business, we introduced two new space reflector products.

A first to market 5 m unfurl about KA band antenna serving the growing market for high throughput satellites, and a new lightweight fit mesh reflector where we also won our first order.

In RF Communications, the international tactical radio business continued to show strength with higher revenue, good orders, and solid opportunities firming up in our 2.5 In RF Communications, the international tactical radio business continued to show strength with higher revenue, good orders, and solid opportunities firming up in our $2.5 billion opportunity pipeline.

We signed a $101 million follow-on contract with a contract in Africa and expect to begin booking orders against it late in the fiscal year.

And we have visibility into several FMS orders in the pipeline, that are moving fairly quickly towards award.

Australia's tactical modernization continues and in the second quarter, we booked a $38 million order for wideband handheld and Manpack radios for the special forces bringing orders to date two $560 million with an additional opportunity of about $90 million on the horizon this latest award positions Harris very well as the future provider of white brand radio for a fully network architecture of the Australian Defense force.

In Iraq in the second quarter, we shipped a significant portion of the $99 million of orders booked in Q1 and additional requirements in opportunities were added to the pipeline.

There was $1.6 billion authorized in G FY15 for the Iraq train and equip find and another $1.3 billion in the president's budget request for 2016 that will support significant offer to for Harris making Iraq one of the larger components in our near-term tactical pipeline.

Also in the quarter we received a $15 million order from a nation in the Middle East for an integrated countrywide Tactical Communications systems based on Falcon III wide band radios.

This nation represents a new special forces customer for us in the Middle East and the award further strengthens our preferred supplier position in the region.

As expected, the US tactical radio market remains constrained that I'm encouraged by the recent pickup in procurement activity.

The RFP for rifleman radio was finally released and bids are due next week and at the final IDIQ contract is now much bigger than we had previously anticipated.

$3.9 billion over 10 years with $1.4 billion for the rifleman itself and it $2.5 billion for objective requirements like a two channel handheld radio waveforms and vehicle adapters.

We submitted a bid for the $390 million next and handheld portion of the SOCOM Tactical Communications modernization effort which we followed over the coming months with RFPs for widespread HF and multi channel Manpack radios.

We now believe that the total so, modernization opportunity could reach $900 million.

Also in the quarter we submitted a bid for Air Force IDIQ contract to integrate and field battle management capabilities.

Before leaving tactical I'll make a few comments on the president's budget request in a tactical lines that support our business, we saw some pick up a Geo 516 across the Marines, Navy, Air Force and so calm so at least beginning to move in the right direction.

For Army modernization, MNVR funding is higher over the five-year period than in the previous year's budget.

Reflecting the programs good progress towards production.

For HMS funding was $65 million for GFI 16 which for us was a positive surprise given that there's still sitting on about $300 million in unspent funds and since the procurement has been pushed out to G FY17. In the out years for HMS the budget matches the procurement schedule with funding picking up in G FY17 to $291 million and rising to $470 million annually in 18 and out.

And public safety, revenue was weak in the second quarter and can cover the pressures remain intense.

Our execution is slowly progressing and we become more evident at the market improves.

Process improvements at all the key areas are resulting in better program execution, lower costs, a more effective sales force, and positive customer feedback on new product releases.

We've made measurable progress but we still have a lot more to do. In Integrated Network Solutions, revenue was about as expected with high single digit growth and CapRock, more than offset by the wind down of two IT services programs. Commercial CapRock revenue was up 15% driven by our previous Carnival cruise line when and we had a particularly good quarter in energy despite the market turmoil with revenue up 8% and orders up 22%.

And healthcare solutions, we continued to receive positive feedback from customers on our Fusion affects software solution and we're making progress in our efforts to find a partner for the business with better domain expertise and channels to market.

We also recently decided to eliminate the INS headquarters functions to reduce indirect expenses of the segment level with Sheldon Fox, President of Government Communications Systems named as the acting President of INS.

This move also better outlines our CapRock business with GCS where we know we have significant technology sharing opportunities that could help us bring more differentiated solutions to CapRock customers.

Now I'll turn it over to Nick to comment on guidance picnic.

Unknown Speaker*

Thank you much bill and good morning to everyone.

We've included our typical segment detail and financial highlights in slides 5 through 8 but instead of reading them in the interest of time I'll go directly to slide 9 for our updated FY15 Outlook.

We are increasing our FY15 earnings-per-share guidance to a range of $4.95 to $5.05 per share from the previous range of $4.75 to $5.00 per share revenue guidance remains unchanged as expected to decline 1% to 3% our guidance doesn't consider the acquisition being announced today.

And RF Communications we've narrowed the guidance range and expect revenue to be flat to down 2%. Within the segment, we expect public safety to be weaker offset by higher international -- US tactical expectations aren't changed.

A bit stronger back half revenue compared to the first half due to the passing of a G FY15 budget and the timing of funds flowing down to customers.

And Government Communications Systems we now expect revenue to be up 2% to 4% and operating margin in the range of 15% to 15.5% and that's a little bit better than before we expect modest sequential revenue growth in the back half.

In Integrated Network Solutions, first half revenue was generally in line with expectations.

Strength in commercial CapRock more than offset by program wind downs in IT services.

While IT services is showing signs of bottoming, we are no longer expecting any pickup and second half revenue and we're assuming that revenue pressure in the CapRock energy market materializes due to the impact of lower oil prices as a result we now expect FY15 revenue to be down about 10% and operating margin of about 7%. We're still expecting free cash flow of about 100% of net income and a full year tax rate between 30.5% and 31% which translates into an average tax rate of about 33.8% in the back half.

About half of the decrease in tax rate guidance is due to calendar 2014 R&D tax credit and the remainder from other favorable tax items. With that, I'll now turn it over back to bill to comment on the acquisition.

Unknown Speaker*

Okay thank you Mick and as Pam mentioned earlier I'm joined here in the room by Dave Melcher President and CEO of Exelis who's offering will offer a couple comments as well so let me turn now to the separate acquisition deck and I'll begin on slide 3. This acquisition brings together two engineering driven companies with similar cultures that value technology and innovation to solve some of our customers toughest mission-critical challenges.

The combined a pro forma company has LPM revenue of $8.2 billion, and EBITDA of about $1.6 billion.

This powerful combination creates an industry innovator with the much greater scale providing a broad spectrum of technology-based advanced communication solutions.

Let me start by providing a high level overview of Exelis and reviewing the transaction details before diving a bit more into the strategic rationale.

So now turning to slide 4, Exelis has a number of leading positions across diverse markets.

Electronic systems which is about 29% of company revenue is a leader in the electronic Ward 4 technologies for the Air Force and Navy.

The principal strengths are in electronic protection and onboard processing on platforms such as the P8, the B-52, the C-130, the Apache helicopter and the international F-16. Exelis flagship product is the integrated defensive electronics countermeasures for I deck, for the F-18 a multibillion-dollar decade-long program with about 400 systems delivered to date.

About a 21% of the company is geospatial systems, a leader in space and airborne sensing.

Exelis is well-known for its world-class space imaging business acquired about a decade ago from Kodak.

The weather sensors as well as their GPS technology.

The imaging business has traditionally served at the intelligence community but is more recently expanded to include commercial, international, and unmanned vehicle payload spirit their products range from a 21 foot wide mirror on the James Webb telescope down to small commercial payloads for the worldview and GUI satellites.

They provided the Gorgon stare wide area surveillance pods for defense UAVs and have recently launched core beside a smaller commercial version targeting the public safety , international markets demonstrating Exelis's skill in translating government technology to the commercial world.

Exelis is whether payloads have been on all know what weather satellites launched since 1978. That Chris or the across the track infrared sounder is a primary instrument on the joint polar satellite system and ABI for the advanced baseline imager is the main mission sensor on those are ABI has also been selected as the main mission sensor for Japan similarity and South Korea's Geo comp set to a weather satellite.

In GPS, Exelis has been on all US GPS navigation systems ever launched and is currently delivering the first payloads for the GPS 3 program.

Information systems is about 34% of the company.

And provides full lifecycle mission-critical solutions for customers like Nassau, where Exelis manages two of NASA's largest communications contracts and the FAA where Exelis owns and operates the 80 SP network a core element of the FAA's NexGen program.

Night vision and Tactical Communications represents about 13% of company revenue.

Exelis has been the industry leader in night vision for over 50 years and is one of only two US manufacturers of image intensification tubes and their Tactical Communications business of a large installed base of more than 600,000 radios.

The remaining 3% of Exelis provides composite aerostructures for commercial and military aircraft.

They have 10,000 employees including about 3000 engineers, $3.25 billion in revenue, and funded backlog of about $2.8 billion.

So turning to slide 5 in the transaction details, total purchase price is $4.75 billion at 23.75 per share and 70% in cash, 30% in Harris shares.

Bridge financings in place.

And we anticipate a combination of term loans and new bonds to both finance the acquisition debt and refinance parts of existing Harris and Exelis debt at what are historically low interest rates.

Pro forma net leverage will be about 2.9 times net debt to adjusted EBITDA at closing with significant pre-payable that and the opportunity to rapidly deleverage.

This structure provides balance sheet flexibility and preserves our ability to invest for growth while we reduce net leverage to about 1.5 times by year 3. Of course, this is subject to approval by Exelis shareholders as well as customary regulatory approval and we expect the transaction to close in June of this year.

On slide 6, as you may know, Exelis has a very large pension liability relating to the legacy ITT business with an unfunded liability of $1.9 billion at the end of 2014. Current historically low interest rates should provide a strong positive bias to net underfunding over time.

We've done significant due diligence work with specialist outside advisers and with a high level of government cash reimbursements, and the smoothing that's allowed in the recent map 21 legislation, pension funding requirements are clear and fully factored into our thinking.

On a pro forma basis, pension liability as a percentage of market cap is well in line with defense peers.

Turning the slide 7, this is a highly strategic and compelling combination.

That generates significant value for our customers.

The complementarity between the two company's technology and capability strengthens our core franchises and provides option elegy for portfolio shaping.

It also builds a stronger platform for growth and immediately creates significant scale, and more balanced earnings for Harris.

Costa synergies are meaningful and the timing of the transaction is excellent given the confluence of an improving budget environment, low interest rates, and a team with the background and the experience to successfully integrate the two companies.

So let me say a few words about each in turn.

Now turning to slide 8, we bring together complementary technologies and capabilities that strengthen our core franchise in space and intelligence, advanced weather systems, air traffic management, and Tactical Communications.

On a pro forma basis, are classified businesses about $1 billion in size with significant growth potential.

For example, by combining Exelis world-class electro-optical technology with our market leading RF capability, we'll be able to offer responsive multi- mission solutions to the intelligence community.

And weather, a tighter linkage between Exelis is on orbit sensors and Harrison ground processing capabilities can help customers increase performance, lower costs, and improve time to market for new weather systems. By having increased access to unique data sets, we can accelerate our push into value added services and predictive analytics.

In air traffic management, Exelis is strong and surveillance, while Harris is the leader in communications and of the combined company will be the prime contractor on four key FAA NexGen programs. And finally, our combined Tactical Communications businesses will drive significant scale efficiencies across our supply chain and our manufacturing assets.

But the combination also provides a stronger platform for growth.

And outside 9 we highlight a few examples leveraging our complementary international channels, pairing our world leading the radios with Exelis his night vision offering, and putting our avionics onto Exelis is existing platforms and then finally accelerating growth in value-added services in geospatial, weather, and airport operations.

So moving to slide 10, this acquisition creates scale and improves our competitive position in the government market and also results in a more balanced earnings profile for Harris.

And slide 11, our diligence work has been thorough and we are confident we can achieve a run rate cost synergies of $100 million-$120 million net of what is returned to customers through cost-plus contracts and fixed-price contracts at periodically reset.

The breakdown of savings is roughly 1/3 of from consolidating headquarters and eliminating public company costs, one third from operational improvements like manufacturing, supply chain, and program efficiencies, and one third from functional efficiencies and overhead reductions.

The cash payback is under two years.

Turning to slide 12, transaction value is $4.75 billion , a multiple of 9.3×2014 EBITDA.

We expect to GAAP EPS to be slightly accretive in the first year.

And a significant contributor thereafter with free cash flow approaching $1 billion in your 4. And then finally on slide 13, the timing for such a transformational acquisition is excellent both internally and externally.

Over the last three years since joining the company, we've focused on improving fundamentals, and shaping our portfolio.

And in the face of a constrained government budget, and declining revenue and environment, we aggressively addressed our cost structure by taking the structuring actions and establishing a formal companywide operational excellence program.

Our Harris business excellence program is now in its third year and it's embedded in our culture.

And the management team stands ready to integrate the two companies to achieve our cost synergy targets.

A full-time senior level integration team is being assembled from the best of both companies and includes my direct oversight.

The time is also excellent from an external point of view the US government spending cycle has bottomed and recent world events only stressed the importance of defense and national security spending.

The President the DoD base budget for FY 16 is up about 8% and even under sequestration, is up modestly with steady growth in the out years.

Interest rates are at historic lows and we estimate that are pro forma cost of debt will be about 200 basis points below where Harris is today with of the weighted average time to maturity of an additional two years.

So as we enter an improving macro environment, our combined company becomes a strong platform for topline growth with our lower cost structure and greater operating leverage driving excellent earnings growth.

Now before open the line for questions, I'd like to turn today for his perspective on the transaction.

Dave?

Unknown Speaker*

Thanks Bill and good morning to everyone.

We had Exelis are very excited about this unique opportunity to bring these two a great and complementary companies together.

The combined enterprises very well positioned to be more competitive in the marketplace and will benefit shareholders, customers, and our employees.

This transaction provides immediate value to Exelis shareholders as well as long-term upside potential from the equity ownership stake in Harris.

We've made a lot of progress since the ITT spin to focus the company.

And we built a strong leadership team with talented and dedicated employees.

I'm confident about the long-term prospects of their Exelis businesses and even more optimistic about the future ahead of us in combination with Harris.

This is indeed an exciting day for us all.

And with that I'll turn it back to Bill.

Unknown Speaker*

Thank you very much, day.

And let's open the call to questions.

Unknown Speaker*

(Operator Instructions) Carter Copeland, Barclays.

Unknown Speaker*

Good morning all.

Congratulations on the transaction and Bill, thanks for the kind words about Joe.

He will be missed indeed.

Just a couple of questions, one, here is specific and then one about the transaction.

First off, the comment about the CapRock guidance planning on weakness materializing bear in the back half of the year because of oil and gas, can you just help us quantify what kind of decline I guess you are protecting for their and then just with respect to the transaction, maybe for Bill and for Dave, when you look at the customer and a channel overlaps and the comments he made about them being complementary, if you could kind of rank order -- what some of those are and what you think the best opportunities and various end markets are if there's space or if there commercial and commercial communications, any color there I think would be helpful.

Thank you.

Unknown Speaker*

Okay, Carter.

Thank you very much for the question.

On CapRock, we -- in the last call and commented a bit on the impact of oil prices.

At the time, oil prices it around $75 a barrel plus or minus and we had not yet seen really anything running into the financials we ended up having a very strong second quarter as I mentioned with orders very strong and revenue up solidly in energy double digit we feel pretty good about that but with oil sitting today below $50, we're seeing a little more pressure coming in the back half.

Is going to be more in the form of pricing.

We have quite a few long-term contracts and CapRock a but even under long-term contracts, we will see -- we do expect to see some pricing pressure and escort to pressure margins is going to pressure topline growth as well so we have accommodated for that in our new earnings guidance for INS and this is why we sort of sized the revenue down about 10% did you want to offer any more on CapRock in the back have?

Unknown Speaker*

Yes.

So what I'd like to note is that it's all relative.

We were expecting some growth in the back half and now it's more stable more than anything so it's relative.

Unknown Speaker*

And on the transaction and I'll say a couple words about this and maybe ask Dave to jump in as well.

But there's -- as we looked at the mix of the portfolios here, there is quite a lot of complementarity in the spaces that I talked about, in space common air traffic management, surely in the weather franchise, we both are in the tactical radio business and have been there for quite some time and reducing a lot of opportunities to work together in the international market, through the channels that we happen to have as a mention about perhaps providing some products through the pretty strong existing Exelis international sales channels and I'm very excited about the opportunities and a value-added services, taking some of the capabilities in unique data sets that come out of the sensors that we have and packaging them in a way that we can sell to a very large a fragmented but growing quickly value-added services market frankly here Exelis is out ahead of us. They've got a very sizable business in this area made a few acquisitions in this space and we've started -- we've been working on this for a year or two are came down a GCS and I think the combination of what they have done and the capabilities that we bring are pretty excited about the growth trajectory and value-added services Dave anything to offer?

Unknown Speaker*

Yes.

No. I think what we're both very excited about is that in this combination offers a full suite of capabilities across space, airborne, Nabel, ground, and cyber domains.

With a number of leading positions in each of that us. I echo Bill's comment with respect to the international sales.

We both have different products that we sell around the world and now we have a much more expensive international network in which to sell those capabilities.

And I agree with the integrated end to end solutions comment for something comedic Haitians information process and analysis and distribution so I really like the fact that the leadership positions that we have with organizations like NASA FAA and our communications customers will only be enhanced by the steel.

Unknown Speaker*

Thank you Carter.

Unknown Speaker*

Thanks.

Unknown Speaker*

Howard Rubel, Jefferies.

Unknown Speaker*

Good morning, gentlemen.

Unknown Speaker*

Good morning.

Unknown Speaker*

Also.

Thank you very much for the time here.

If you wouldn't mind either bill or Descartes kind of talk for a couple minutes and some of the deal metrics and I have sort of one or two questions and if you could help that would be appreciated.

First, you talk about some of the cash investment cause.

Did you include in that some of the refinancing in their?

And then, second, if I'm thinking about the cost of funds, based on the sort of where rates are today and I know they can move, we're looking -- is a 4% kind of range a reasonable number?

And then last, related to that, while you have some terrific synergies you also have from a GAAP perspective my guess would be some either amortization or some intangibles and some of that's going to be frankly non-cash so there's some real benefit there that GAAP will mask and it also creates some tax shelters if you wouldn't mind sort of providing a little bit of structure to that I'd really appreciate it.

Unknown Speaker*

It's quite a mouthful, Howard.

Thank you.

And I'm going to start --

Unknown Speaker*

Sorry.

Unknown Speaker*

I think I got most of the points but perhaps between Nick and I will hit your points and if we miss one, let's keep going on with that.

So on terms of the structure, we expect will close in June.

So there are going to be a number of transaction-based costs that will hit in June and will be impacting our FY15. As we go into FY 16, we do see the transaction to be slightly accretive.

We do expect that of course we'll have the Exelis EBIT coming in in the FY 16 so that is going to be a positive.

We see integration costs which are going to be a little bit more front end loaded in fact a lot more front end loader hitting FY15 and they'll be more than the savings we get from integration.

We do see in the first full fiscal year some benefits from the pickup of unamortized pension losses that we know exist at Exelis and it's going to be offset by deal amortization which will be substantial and battle be in FY 16 so all of those pieces come together and we do see a very slight accretion in our FY 16 again hinging on a close in June should that move into July or thereabouts our FY 16 of course will be impacted by that.

You asked a question about the cost of borrowing about 4% we do expect it to be lower than that.

And we were thinking make on a weighted average basis it'll be sort of between 3% and 4% is kind of 3.5% so any other comments Nick on?

Unknown Speaker*

Yes.

Absolutely I think in FY15 we will have refinancing costs which are not included but we will also incur some deal cost, some financing fees, a little bit of restructuring.

Moving on to the cost of funds, the way we hope to finance this as alluded before and is 30% of equity and 70% that, we've taken the opportunity to refinance some of our short-term debt in order to have rapid repayment about half of our debt is going to be within five years and more than half of that will be term loans that which are very easily prepaid so that cost of debt of the comfortable go down as we alluded to about 200 basis points and there will be at or about or below 3.5% level.

Unknown Speaker*

So Howard did I hit all the Commodore the questions that you asked?

Unknown Speaker*

More or less.

I mean, I just think the think that's striking and very impressive is that the cash synergies over time are going to be very strong and it's very come from entry.

I mean, if anything, my observation is I was slightly higher but I guess you are one of these start out conservative but no. This is great.

Thank you very much.

Unknown Speaker*

Thank you Howard.

Unknown Speaker*

Peter Skibitski, Drexel Hamilton.

Unknown Speaker*

Congratulations to Bill and David and Mick and Peter and I would echo Carter's comments about Joe.

And I guess bill, first question, on the pro forma free cash flow per approaching $1 billion in your for just wondered what kind of topline assumption your factoring into get to that.

Unknown Speaker*

We do see that the business together will start to grow in the top line probably in FY 16 more likely in FY17 we're still does that to put together our plan were not giving guidance in FY 16 but I think all indications are for topline growth but frankly when you just look at the free cash generation of our combined companies today, you look at the cash contributions which are more smooth coming in the future for Exelis associated with a penchant, and then the cash return from synergies it being generated, by year 4, we do see ourselves approaching about $1 billion in free cash flow.

And that is also looking at there will be probably some opportunities in capital spending since we do have very complementary businesses it's very likely we'll have some opportunities to take a hard look at how we each spend capital in look for opportunities as well so all those pieces together, Pete, come together to drive is about $1 billion in about four years.

Unknown Speaker*

Okay.

That's helpful thank you for that.

And then just on the -- I went comments about the cash investment of $130 million-$150 million so those aren't transaction processor restructuring cost maybe or something else?

But that's correct their synergy cost investments to capture the synergies and again I want to be very clear.

Those investment cause and the savings on that chart our net.

Of what we would be working with our government customer on so that is what is accruing to our shareholders.

Unknown Speaker*

Okay..You.

And then I guess my last question, just any -- obviously you guys are one of the few companies in the industry that kind of utilize the commercial pricing model and I was wondering if you had any thoughts as you were looking at this deal surrounding an opportunity to take your commercial pricing model to certain of the Exelis products or is that just not applicable.

Unknown Speaker*

I think we on a commercial pricing model commercial model at Harris is mostly in the our business and I think when you look at the and BCS business from Exelis it follows largely the same model.

I think on the rest of Exelis looks more like what we see a GCS which is sort of more typically government type record type programming so I think that's what does I think we look very similar from that perspective, Pete.

Unknown Speaker*

Okay.

Thanks so much.

Unknown Speaker*

You bet.

Thank you.

Unknown Speaker*

Cohen.

Unknown Speaker*

I also shared your feelings about Joe.

If the real tragedy.

Hey, wanted to ask if you could just help quantify what you anticipate the intangibles amortization to be. Because this deal actually does look a heck of a lot more accretive at first blush then your indicating so I'm trying to understand if you could quantify intangibles maybe some of the other items that we're not thinking about.

Unknown Speaker*

In year one and 2.

Unknown Speaker*

Yes.

A look at maybe just a little bit more color.

I mean we just we're announcing a today we've had a lot of work here to do to sharpen the numbers and will do that between now and clothes and provide you a little bit more guidance as we understand the pieces quite a bit more.

I would say of the total investment, it's going to be more front end loaded.

It'll be more in FY 16 sort of on the order of two thirds will come up in the first year, then it will flow down the second year maybe one third with a little trickling down into the third your second year into the third year.

We seem the intangible amortization to be in the range of about $130 million-$140 million is our estimate today.

We do see savings starting to flow in and FY 16 but as I mentioned integration costs will be higher than the savings.

And then it starts to flip as you get into FY17 so more savings and cost and you start to him more run rate into FY 18 where cost of integration are relatively low.

I think those are the major pieces that I think I could probably comment on here today make anything?

But a couple of our accounting -- first and foremost just based on the latest 10-Q of Exelis has about $24 million in intangible amortization brand and purges accounting that will go away.

So the $130 million is it that we mentioned before here does $130 million or $140 million is what we will incur so you have to take that into account when you combine both firms and then also of import is in their pension, they have a net accumulated actuarial bus with purchase accounting also goes way and you can calculate that and I think the last reported number four that was $2.3 billion as of the end of 2013 and the amortization of that is in the range of I don't know the does $100 million per year.

Unknown Speaker*

Okay.

So that's $80 million-$100 million sort of additive to the Place.

Unknown Speaker*

Probably on the lower end of that.

Unknown Speaker*

Yes.

Unknown Speaker*

Okay.

So the EBIT that you guys are assuming from Exelis is in excess of the $400 million or so that they report.

Is that what you're suggesting to be clear?

Unknown Speaker*

Yes.

Unknown Speaker*

Okay.

And then with respect to the cash investment costs on slide 11, that is specifically for what?

If you could just give us -- is it the three buckets that you talked about on the left their?

Or is that inclusive of other deal cost that you hadn't called out?

But yes.

We should be very clear about that it really refers to what's on the left.

There are no deal costs that are in the $130 million-$150 million those our investments that specifically yield a return or a savings of synergies.

Unknown Speaker*

Okay.

And so what order of magnitude are we talking about with the deal costs you've yet to quantify?

Unknown Speaker*

I think we're going to maybe sort of use that as an opportunity to communicate a little further down the path to investors on what that happens to be at this point.

They're going to be in our FY15 let's -- will come back to you and others over the coming weeks with get a little bit more shape around what those costs happened to be.

Unknown Speaker*

Thanks a lot guys.

Good luck.

Unknown Speaker*

You bet.

Thank you.

Unknown Speaker*

Josh Sullivan, Sterne Agee.

Unknown Speaker*

Hey Josh.

Unknown Speaker*

Good morning.

Unknown Speaker*

Good morning.

Unknown Speaker*

Congratulations on a nice quarter and exciting future with Exelis here.

Just given the move with the INS headquarters now with the Exelis assets are there other areas in the legacy portfolio such as healthcare which may not be as strategic going forward?

I think you might have mentioned portfolio option our T.

Unknown Speaker*

Yes.

Clearly when you take the two combined companies and put them together we'll take a hard look as we have done and I know Dave has done in his portfolio is to -- the strategy and the strategic rationale of holding onto assets of course will have a broader look across a broader portfolio and we'll continue to do what we each have done individually on the broader portfolio that's not error near-term focus certainly our near-term focus right now is I'm getting from signed to close closing the deal, launching integration making sure the successful post integration period and that's what we're laser focused on at the moment.

Clearly there's going to be a realignment of the way we are organized in this transaction and what we decided to do with a INS headquarters is a relative to what Harris was doing standalone but also relative to what we are preparing ourselves to do in a close so it's completely online that same direction.

And that's as far as I'll comment today on any portfolio shaping.

Unknown Speaker*

Okay.

Thanks for that.

Unknown Speaker*

You back.

Unknown Speaker*

And then it may be just a little question was that DoD positioning just on M&A transaction such as these right now?

Unknown Speaker*

Well, look, I think our defense customers in fact all of our customers are going to be excited about this transaction.

I think they are very interested in a vibrant, stable, industrial base.

They're interested in enterprises that in invest in innovation and technology and we demonstrated the willingness and ability to do that the that are interested in innovation but affordable innovation and they'll be sharing in the savings associated with the consolidation of these companies.

There stimulating competition in the industrial base and I think we'll be a more competitive franchise so in my believe, all of our customers including our defense customers will be quite excited about the transaction.

Unknown Speaker*

Okay.

Thank you.

Unknown Speaker*

You bet.

Unknown Speaker*

Goldman Sachs.

Unknown Speaker*

Good morning everyone.

Unknown Speaker*

Good morning Nolan.

Unknown Speaker*

Just wanted to echo your condolences to Joe and his family.

Obviously extremely tragic.

So just wanted to add those comments there.

On the business, if I look at RF on the top line for the remainder of the year, it looks like you have to have a pretty nice acceleration going from a revenue declined to revenue growth their and the comps aren't much easier when comparing to last year.

And order momentum is a little bit stagnant so can you maybe just talk about what's picking up in the back half within RF?

Unknown Speaker*

Yes.

We do see a little bit of a softer public safety Outlook.

We do see DoD strengthening a little bit because there's a budget and there's flow down of funding and we see that picking up and we're -- we're seeing a lot more activity on the DoD side but frankly were very encouraged by the strength and resilience of our international tactical pipeline it strong.

Remains about $2.5 billion even when we continue to book orders it continues to refresh quickly.

I've talked at some length about what's in it and the prospects on the horizon.

Of lot of activity is moving in the pipeline and we feel very good about what's happening in the back half and international tactical radio so today we see international tactical up a little bit more than we thought a quarter ago offsetting a little bit of the softness we see in public safety our DoD Outlook for the year really hasn't changed.

Since we started the year.

Unknown Speaker*

Okay.

So what kind of full-year international growth rate are you looking for now?

Unknown Speaker*

I don't think we're going to talk about sort of the international business tactical on a standalone basis but we do see that to be up . Last time we were saying it's up low single digit.

Is probably of a little more than that like my mid to high single digits in that range.

As last time we said DoD was going to be down low double-digit it's about the same sort of as I mentioned them before down 10% to 12% so that hasn't changed.

PSPC where we thought was flat is more down mid-single digits so I think hopefully that characterizes a bit more how we see the full year in RF.

Unknown Speaker*

Okay.

And then kind of the same question on the margin in the segment, can you maybe elaborate a little bit on what was weaker in the quarter ? And then to get into the range for the full year, the back 2:30 pick up pretty nicely versus the trend of kind of ongoing pressure we've seen their.

So what drives that in the backend?

Unknown Speaker*

Yes.

That's a good question.

I mean, look, overall we been pretty consistent at that margin guidance for the and our best 30% to 31% in the first half we are little light we are 29.5% roughly for the first half and came in about 29.2% in Q2 but at Q2 we had some adverse mix we had a lot of systems business we had some additional R&D expenses that rolled through in the quarter in Q2 and I've been very, very clear on these calls about our willingness to invest more in our RF this is particular tactical radios and you are seeing those investments flowing through and of course in Q2 we had given the volume slightly lower margins and public safety then we had anticipated earlier in the year.

So second half is going to get stronger because we will see much stronger product mix coming through the business.

And we feel very confident that we'll come in at between 30% and 31% on a full-year basis.

Unknown Speaker*

Okay.

And then, could you similar be update us on the pieces of INS for the full year?

In terms of a growth rate in the IT services business and in CapRock?

Unknown Speaker*

Yes.

What we've seen in this business is particularly in hits on a year-to-year basis they've lost two a major -- were in the wind down of two no jerk programs and NMCI so that is a significant year and year when I look at the revenue for hits, what you'll find is declines in the low double digits but the commercial is continuing to do well.

On healthcare, it continues to grow year on year.

And all in all, it's about macro environments.

Right?

Were having energy issues.

Oil prices are affecting that.

Unknown Speaker*

Okay.

And then, if I could just ask one more on the transaction.

Could you guys talk a little bit about what your diligence found on the 80th be program over at Exelis.

Seems like a large lawn opportunity but also seems like the type of thing that can take longer than expected or kind of easily slide to the right and so I was just curious how you were thinking about that program.

Unknown Speaker*

Well, not going to go into specifics about what we found in diligence I think Dave and his team have talked a lot about this trade with the FAA , the maturity of the ADF program and the confidence that the administrator has placed in a DSP the commitment to it. The drive and the mandate on equivalents by 2020 holding firm on that and we feel good as I think Dave and his team feel about a DSP.

It's a great program there performing very very well I think the FAA is very pleased and is going to fit very nicely with the things that we do today with the FAA as you know we're on the FTI program we've been on that for 15, 20 years.

We have the next-generation voice switch program as well as Datacomp so I think the programs that we work on with the FAA the strong reputation we have their with the FAA is going to be augmented by the very strong reputation that Exelis enjoys on adsb with the FAA as well as I think we feel very good with our position their.

Unknown Speaker*

Okay.

Thanks very much.

Unknown Speaker*

I appreciate it and I think that wraps is up for today thank you everyone very much for joining us and that --

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Unknown Speaker*

This concludes today's presentation.

You may now disconnect and have a wonderful day.

Unknown Speaker*

[Event Concluded]
