THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

HRS - Q2 2016 Harris Corp Earnings Call

EVENT DATE/TIME: FEBRUARY 02, 2016 / 1:30PM GMT

OVERVIEW:

HRS reported 2Q16 revenue of $1.84b and non-GAAP EPS of $1.49. Expects FY16 revenue to decline 5-6% and non-GAAP EPS to be $5.70-5.80.

THOMSON REUTERS

CORPORATE PARTICIPANTS

Pamela Padgett *Harris Corporation - VP of IR*

Bill Brown *Harris Corporation - Chairman and CEO*

Sheldon Fox *Harris Corporation - SVP of Integration Engineering*

Mick Lopez *Harris Corporation - SVP and CFO*

CONFERENCE CALL PARTICIPANTS

Gautam Khanna *Cowen and Company - Analyst*

Noah Poponak *Goldman Sachs - Analyst*

Pete Skibitski *Drexel Hamilton - Analyst*

Seth Seifman *JPMorgan - Analyst*

Robert Stallard *Royal Bank of Canada - Analyst*

Carter Copeland *Barclays Capital - Analyst*

Josh Sullivan *Sterne CRT - Analyst*

Chris Quilty *Raymond James & Associates, Inc. - Analyst*

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Harris Corporation's second-quarter 2016 earnings conference call.

(Operator Instructions)

As a reminder today's call is being recorded. I would now like to turn the conference over to Pamela Padgett, Vice President of Investor Relations. Ma'am, you may begin.

Pamela Padgett - *Harris Corporation - VP of IR*

Thank you. Good morning, everyone and welcome to our second-quarter FY16 earnings call. I'm Pamela Padgett, and on the call today is Bill Brown, Chairman and CEO; Mick Lopez, Senior Vice President and Chief Financial Officer; and Sheldon Fox, Senior Vice President, Integration Engineering.

So first a few words on forward-looking. Forward-looking statements made today involve assumptions, risks, and uncertainties that could cause actual results to differ materially from those statements. For more information and a related discussion, please see the press release, presentation, and Harris' SEC filings.

In addition a reconciliation of non-GAAP financial measures discussed today to comparable GAAP measures is included on the Investor Relations section of our website, which is www.Harris.com where a replay of this call is also available. Okay, with that, Bill, I'll turn it over to you

---

Bill Brown - *Harris Corporation - Chairman and CEO*

Thank you, Pam, and good morning, everybody. Our second-quarter and first-half results are largely in line with our expectations for how FY16 would unfold. While Q2 revenue was a bit weaker than expected, we anticipated operating within a continuing soft revenue environment, with Q2 being the weakest of the year relative to prior-year results due to the budget process and a difficult compare in the legacy Exelis business.

And as we previously communicated, our number one priority this year would be integrating Exelis and realizing the synergy savings in earnings accretions we promised. And we are executing well against that goal.

We're also delivering on our commitment to maximize free cash flow, to quickly de-lever, and to dispassionately evaluate portfolio reshaping as today's announcements and results will demonstrate. Second-quarter earnings were solid and free cash flow was particularly strong, and again this quarter we made excellent progress in achieving integration savings.

We've also identified additional opportunities and now expect to reach run rate savings exiting FY17 of $140 million to $150 million, significantly higher than the $120 million we previously communicated. First-half free cash flow was supporting our deleveraging priority, reducing term loan debt $200 million in the quarter and $383 million since closing the transaction in late May.

We're also pleased to report being far down the path of divesting the aerostructures business, which was part of the Exelis acquisition and was determined to not be strategic to Harris. Aerostructures is currently reported within the electronic systems segment and had calendar 2015 revenue of $77 million.

After receiving considerable interest from potential buyers, we're narrowing the group to a select few and expect to reach a definitive agreement soon. We'll also continue to evaluate our now much broader portfolio with a dispassionate view towards which businesses are strategically aligned and which are not.

We also continue to adapt to market conditions and adjust our cost structure accordingly as we have in the past. In the second quarter, due to the prolonged downturn in CapRock's energy market, we took a non-cash writedown of goodwill and other assets and we launched restructuring and other actions that were primarily in CapRock.

Our goal is to right size the business in line with market conditions, and these latest actions reduced their headcount by about 20%. When combined with steps we took in Q4 last year, headcount at CapRock will be down about 35% over the last 18 months. Altogether these actions are expected to generate modest savings in FY16 and about $20 million to $25 million in FY17.

So let me turn quickly to quarterly results in slide 3 in the presentation. And I'll reminded you that our discussions today are on a non-GAAP basis.

Earnings per share was $1.49, with acquisition savings supporting operating performance in a still relatively soft revenue environment, with the recently reenacted R&D tax credit contributing $0.10 per share. Reported revenue was $1.84 billion compared to $1.21 billion in the prior year.

And on our organic basis, while we anticipated a difficult year-over-year revenue compare, it was a little weaker than expected at down 14% so let me give you a little more color on the drivers. About 4 to 5 points of the decline related to Exelis overdrive in their Q4 2014 results.

Government and IT services contributed another 5 points which, as we mentioned before, would be impacted by the wind down of a couple of large contracts in a still slow procurement environment. And CapRock was another point or so with the remaining business contributing about three points.

On the positive side, Harris' legacy international tactical revenue was up a strong 10% in the quarter resulting in Harris total legacy tactical revenue at about flat with the prior year and about as expected for the quarter. Revenue was also higher in geospatial imagery driven by the continued ramp of our large classified foundation, GEOINT Content Management program, and was also hired with the FAA driven by next-gen modernization programs.

On a sequential basis for the Company, revenue was up 2% with all segments higher except critical networks, which includes IT services and CapRock. Orders in the quarter were $1.5 billion, and together with strong orders booked in Q1 first-half book to bill was just over 1.

In IT services, although revenue was down in the quarter, orders were encouraging, driving a book to bill of 1.1 for the quarter and the first half. And we expect first-half orders combined with incumbent positions on existing programs will support back half revenue stability.

In CapRock our strategy to diversify our business into the cruise market where bandwidth demand is growing is helping to offset a bit of the energy revenue weakness. Over the last two years bandwidth demand on cruise ships has increased exponentially from an average of less than 5 megabits per ship to now 35 megabits with 1 gigabit in sight for the largest vessels.

And it's important to note that our position in the cruise market is solid with two a half years left on our five-year agreement with Carnival and another five years left with Royal Caribbean following a contract extension that was awarded in the quarter. Perhaps as important, diversification brings us significant volume leverage for purchasing satellite bandwidth. And our scale has allowed us to consolidate bandwidth, drive down cost, and implement a sales approach of one price over one global system regardless of market to further drive efficiency gains in the organization.

In tactical communications we previously highlighted US funding support for foreign military sales from both the base budget as well as from OCO accounts for special initiatives such as the European Reassurance initiative, the Counterterrorism Partnership Fund for Middle East and Africa, and the Iraq Train and Equip Fund, or ITEF. The funding supported our strong 1Q bookings and in 2Q we booked $66 million in orders supported by ITEF.

We ended the first half of the year with an international tactical book to bill of 0.99. On the US tactical front, progress continues to be made on army modernization, and we were encouraged that the army requested best and final offers from all bidders for the two channel manpack radio and reconfirmed their calendar Q1 award date.

In public safety orders were up more than 30% on a week prior-year compare with book to bill greater than 1 on a fairly good revenue level of $109 million. Orders included $20 million from Arizona public services, the state's largest electric utility company, and $18 million from the Air National Guard that includes our latest product offering, the multi-band XL-200P radio.

While we're still not satisfied with our public safety results, we've expressed multiple times that improving performance in the business will come as a result of solving basic execution challenges, introducing new products, improving quality, strengthening front line and program management capabilities, and we're beginning to see positive signs that the business is slowly turning the corner.

In space and intel on top of strong Q1 wins from classified customers we received healthy orders of $172 million, and another $23 million contract to support space superiority missions. Space superiority and protection has become a US defense priority, and is expected to receive $8 billion in funding over the next five years. Our first half wins in space superiority combined with the strong funding support should make us an area of solid growth for the Company into the future.

And following the close of the quarter, the space and intel segment was awarded a $316 million follow-on contract for NASA for the Cross-track Infrared Sounder, or CrIS, payloads on the third and fourth weather satellite for the joint polar satellite system. These payloads provide key global data used by the National Weather Service, and for Harris the award continues the strong customer relationship we enjoy with NASA and with NOAA.

And then just recently in critical networks we were awarded a nine-year $44 million contract from the UK's internet navigation service provider called NATS to modernize their voice communications infrastructure. This represents our first international win in this area, and results from leveraging technology provided under the FAA's next-gen modernization program to now address the global market.

So with the successful integration of Exelis as our number one focus for the Company, I've asked Sheldon to join us again this quarter to provide a little more detail on integration and the additional opportunities the team has identified. Sheldon?

Sheldon Fox - *Harris Corporation - SVP of Integration Engineering*

Thank you, Bill, and good morning, everyone. We turn to slide 4.

Again this quarter we've made excellent progress in achieving integration savings and have identified several new opportunities. The team quickly developed plans to capture these additional savings, and we're pleased to report that 100% of our cost-saving projects are either complete or in progress. As Bill noted earlier, we now expect net run rate savings to be in the range of $140 million to $150 million as we exit FY17, up significantly from our previous estimate of $120 million.

Associated with this, we now expect gross integration cost of $250 million and net cost of $200 million after government reimbursements. The additional savings are primarily in two areas: footprint rationalization and supply chain.

In the Q1 call we highlighted moving the SINCGARS tactical radio manufacturing operations from Fort Wayne to Rochester. And just last week we completed production of our very first SINCGARS radio assembly in our Rochester state-of-the-art manufacturing facility. With this project well under way, we've launched new facility consolidation projects in five locations that will reduce footprint by an additional 230,000 square feet, bringing total Company square footage reduction related to the acquisition down 15% since closing.

The second area of additional savings comes from a thorough review of our supply chain. We've spent a lot of time building the database to compare what Exelis buys to what Harris buys and what each pays on price down to the individual part number to understand our supply chain spending across the combined company.

With this database in place, we launched multiple projects across a broad range of spend categories, from electronic components to company travel, to eliminate price disparity and leverage our much larger volume to reduce cost. We also launched should cost analyses and value engineering initiatives to further drive supply chain savings.

A quick example is a should cost analysis that identified a 20% reduction in the price of a key component used across our night vision product line. We see a lot of opportunities like these which will add to our pipeline of regular annual operational excellence projects.

And while not highlighted on the page, an underlying core theme of our integration is to reduce complexity throughout the company. And we're using this opportunity to take a best of both companies approach to simplify and standardize across the new Harris. We've already reduced the number of health plans by 50%, corporate policies by 40%, and legal entities by 12%, and we're targeting a 50% reduction in core IT applications and an even greater reduction in the number of data centers.

So as we enter the back half of the first year of integration we are excited about the progress so far and confident that driving standardization and simplification across the business will build a solid foundation for the future. And with that, I'll turn it over to Mick to discuss segment results.

Mick Lopez - *Harris Corporation - SVP and CFO*

Thank you, Sheldon, and good morning to everyone. Before turning to each segment, we'll provide some color around the one-time items in the quarter that are excluded from our non-GAAP results and also point you to the GAAP to non-GAAP reconciliations on slide 5.

Unrelated to the acquisition we had a $367 million non-cash charge to write down goodwill and other assets in the CapRock business as a result of the prolonged downturn in the energy market. Acquisition related items included a $101 million benefit for a net liability reduction for certain post-employment benefit plans, $43 million of integration costs, and a $3 million charge related to inventory step up.

We also had restructuring and other charges totaling $35 million, with the majority for workforce and facility reductions. So turning now to segment detail on slide 6 and comparisons to prior-year pro forma results, as if Exelis and Harris were combined for all of FY15.

Communication systems segment revenue was $489 million compared to prior-year pro forma of $539 million. Tactical communications revenue was down 10%, declining primarily due to weakness in Exelis legacy tactical and night vision product lines.

Harris legacy tactical communications was about flat as a result of strength in international. Public safety revenue was $109 million compared to $116 million in the prior year, declining year-over-year but up 18% sequentially quarter-to-quarter. Operating income in the second quarter was $138 million, and operating margin was 28.2%, compared to last year's operating income of $144 million and 26.7% margin.

Turning to space and intelligence systems on slide 7. Second-quarter revenue was $446 million compared to prior-year pro forma of $488 million.

Higher revenue from two classified programs, including the Foundation GEOINT content management program, was more than offset by the completion of other classified programs and lower GPS III revenue. Operating income in the second quarter was $67 million, and operating margin was 15% compared to last year's operating income of $87 million and 17.8% margin.

Turning to electronic systems on slide 8. Second-quarter revenue was $382 million compared to prior-year pro forma of $451 million. Higher revenue from the ramp in F-35 production was more than offset by lower electronic warfare revenue. Operating income in the second quarter was $69 million and operating margin was 18.1%, compared to last year's operating income of $78 million and 17.3% margin.

Turning to critical networks on slide 9. Second-quarter revenue was $541 million compared to prior-year pro forma of $672 million.

Lower revenue in IT services and CapRock's energy market was partially offset by higher FAA revenue driven by next-gen modernization programs. Operating income in the second quarter was $71 million and operating margin was 13.1% compared to last year's operating income of $83 million and 12.4% margin.

So let me turn it back to Bill for the guidance discussion and a few wrap-up comments.

Bill Brown - *Harris Corporation - Chairman and CEO*

Thank you, Mick. So moving to slides 10 and 11. Revenue guidance on an organic basis is revised from down 3% to 5% to now down 5% to 6%.

We expect the impact of lower volume on earnings to be more than offset by the flow-through at the R&D tax credit and cost savings across the Company. As a result, non-GAAP EPS guidance has been increased to a range of $5.70 to $5.80. And to remind you non-GAAP includes intangible amortization from the Exelis acquisition of $133 million, or about $0.70 per share.

In communication systems its expectations are unchanged. In space and intel operating margin expectations have been revised to a range of 15% to 15.5% primarily to reflect a higher mix of cost-plus revenue and new program starts.

In electronic systems revenue expectations have been revised to a range of down 2% to 3% due to a few losses in electronic warfare pursuits combined with a slower than expected ramp of previous electronic warfare wins. In critical networks revenue expectations have been revised to down about 14% due to further weakness in government IT services and CapRock's energy market.

So to wrap up, as I said upfront our top priorities are successfully integrating Exelis, delivering strong free cash flow, deleveraging our balance sheet, and continuing to reshape the portfolio. And through the first half of the year we are making good progress on all of them.

So while we still face top line pressure in FY16, integration and other cost reduction actions are driving good earnings growth, and we expect this rising trend in earnings to continue into FY17. And with that, I'd like to ask the operator to open the lines for questions.

QUESTIONS AND ANSWERS

Operator

Thank you. (Operator Instructions)

Gautam Khanna, Cowan and Company.

Gautam Khanna - *Cowen and Company - Analyst*

Yes, thanks, good morning. I was wondering if you could give us some of the metrics you've provided in the past with respect to tactical backlog, technical backlog, book to bill and the respective pipelines US and foreign?

Bill Brown - *Harris Corporation - Chairman and CEO*

Okay, that's a lot of information that's in there. Let me see if I could hit on some of the key things, and I'll provide you as much as I can on that.

First off on the book to bill, this is all legacy tactical radio, so back to the way Harris defined tactical radio, our book to bill in the first half was 0.97. So international was 0.99, as I mentioned on my remarks, and DOD was a little bit less than that. A little bit softer in Q2, but we had very strong Q1. Remember it was about 1.3.

Revenue we believe came in about as expected in the quarter, a bit stronger in international which as we said was up 10%, a little bit lower in the DoD. Its flat overall in Q2 and up 3% in the first half. So I think overall a pretty decent start. For the full year we still see revenue being flat to down low single digits, we still see DoD to be flat to up slightly, and international to be down slightly on a year-over-year basis.

It's really shaping up almost as we had expected when we initiated guidance six months ago; up first half, down in the second half on a year-over-year basis. With two bigger tranches in two specific countries winding down, that makes for tougher comparisons in the back half.

We still see sequentially the second half being up versus the first, with Europe and the Middle East both contributing pretty nicely. In fact guiding this year we think Europe is shaping up to be a record or near record year for us, driven a lot by this ERI/US government funding for Ukraine and the Baltics as well as a few other central European/eastern European countries.

But we do see the impact of lower oil pricing that is shifting some of the priorities in some of the countries in the Middle East as well as some of the priorities of the US government. So that's giving us a little bit more caution in the back half. But still we see second half up sequentially from the first.

Now let me turn to the pipeline and just quickly cover that. On the international side the pipeline is still very robust. It's now $2.9 billion, last time it was $2.4 billion. So it's come up as we brought in about a $600 million opportunity for phase III modernization in Australia. We expect that award at the end of FY17, so that is now into our 12 to 18 month pipeline.

The Middle East is still very solid. On a dollar basis it's still about the same as it was before. On a percentage basis down a little bit, now slightly under 50% because the size of the overall pipeline has increased. So still very, very broad again.

Europe is strong, Cal is holding serve, and we see Asia coming up pretty nicely, mainly because of Australia. So that's on the international front.

On the DoD side the pipeline is at $890 million, so down slightly from where we were last time at about $925 million. So it's just under $900 million. The mix is still about the same, 60% Air Force, SOCOM, Marine Corps, and about 25% being Army in part modernization and part resets and other opportunities.

So let me stop with that, Gautam, and see if I answered the question that you were trying to get at.

Gautam Khanna - *Cowen and Company - Analyst*

Yes, you definitely did. And I was wondering also originally when you announced the acquisition of Exelis you laid out a $1 billion free cash flow target a couple years out. I was wondering if you -- with the new synergy target and what have you, are you still comfortable with that? Do you see upside to that?

And if you could maybe bridge us from where we are today at $750 million of free cash to that $1 billion? What are the big puts and takes that get us there?

Bill Brown - *Harris Corporation - Chairman and CEO*

First I think for this year we're still feeling very comfortable at a free cash guidance of around $750 million, as we noted in our guidance. And that numerically hasn't changed. The words around it have, but numerically its the same as we guided before; its the $750 million.

And without getting beyond 2016 guidance, we do still see three or four years out $1 billion in free cash flow. And the drivers are as we expected before.

We do see the higher run rate synergies impacting that free cash flow, so growing from $750 million. We see interest rate reductions, interest cost reductions coming down because we're paying down some debt.

We do see continued working capital performance improvements over time. Recall we are at, as Harris last year in FY15, about 46 days of working capital. Exelis was quite a bit higher than that. We came in at about 56 days at the end of Q2.

So just as we get back to where Harris was before, we see another 10 plus or minus days of improvement in working capital at about $20 million per day. So we'll close some of that this year, but even if we don't close all of that it still could be substantial increases in cash flow just simply from working capital. Of course we also see a little bit of capital spending efficiency over time as well. So those are the major elements again we are still confident about $1 billion three to four years out.

Gautam Khanna - *Cowen and Company - Analyst*

Okay, thanks a lot, guys. I'll turn it over.

Operator

Noah Poponak, Goldman Sachs.

Noah Poponak - *Goldman Sachs - Analyst*

Good morning, everyone. Just from a disclosure perspective, I had the same question as Gautam and I've probably had it emailed to me two dozen times already this morning from your investors just on what in the quarter the domestic and international organic revenue growth and book to bill were.

So I know the business has become more complex with Exelis, but if it's possible to just provide that in a clean way in the decks going forward I think that would be helpful. Just as one person's opinion.

Pamela Padgett - *Harris Corporation - VP of IR*

Okay, thank you, Noah.

Noah Poponak - *Goldman Sachs - Analyst*

In terms of the Middle East comments you just made there on the international piece, Bill, could you maybe just go back to that a little bit? At first I thought I heard you make an incrementally positive comment, then I thought I heard an incrementally negative comment.

And we hear a decent amount of concern out there on what might happen in that business for you because of the oil price. So can you just dig a little further into the trends? And if you're able to size how big that is as a percentage of your international business right now, that would be helpful.

Bill Brown - *Harris Corporation - Chairman and CEO*

Well we've been cautious over the last two or three quarters that the declining oil prices are impacting steam needing to put some friction in the pace of awards that we're seeing in the Middle East. It doesn't impact the overall size of our international or our Middle East pipeline.

We still see opportunities there, the flow of those opportunities through the pipeline are seeing a little bit more friction. And we know in Saudi, Saudi has been a significant opportunity for us, one of the biggers in our pipeline, like Iraq happens to be and others throughout the Middle East.

There are five or six countries that make up the biggest part of our international -- Middle East part of our pipeline. And we do see in Saudi in particular where they are focusing on the war in Yemen and military purchases to support that.

We're seeing some of the opportunities on our radio business slip a little bit to the right, both in terms of Harris as well as what was legacy Exelis. So that has slipped a little bit to the right.

But overall, Noah, I think the opportunity in the Middle East still remains out there, the pipeline size is still very good and very robust. I'm very encouraged by the fact that there is strong US government support, FMS support for opportunities in the Middle East.

And I mentioned in my prepared remarks, we talked about this last time, the ITEF funding, that float from the US government is flowing in and is helping us in Q2 we do expect to see more opportunities in the future. GFY16 it was about just over $700 million worth of ITEF funding.

There is this counter-terrorism partnership fund which includes amounts for Syria, it's $1.1 billion. So there's lots of US government funding that does backstop our Middle East pipeline. So as I said in my remarks, we do see on a year-over-year basis the second half in tactical to be down but sequentially up first have to second half.

Noah Poponak - *Goldman Sachs - Analyst*

Okay. Is it possible to size how much of your international revenue comes from the Middle East in tactical radio?

Bill Brown - *Harris Corporation - Chairman and CEO*

It's probably -- on the pipeline itself it's just under 50%, so it's probably on the international side of our revenue, it's 40%, 50%

Noah Poponak - *Goldman Sachs - Analyst*

Okay, thank you. And then at CapRock sort of a similar question, can you quantify what that's run rating now on a quarterly or annual basis, just so we can get a sense for I guess how much it's already come off the peak. And what are margins like in CapRock energy at this point?

Bill Brown - *Harris Corporation - Chairman and CEO*

The CapRock energy business year-and-a-half ago was around $400 million and down about 30%. So it's running this year just under $300 million on a reported basis for FY16.

We would expect by the time we hit Q4 to be a run rate somewhere around $250 million or a little less than $250 million is the way that we are sizing it. So that's on or around $60 million, $65 million per quarter.

And will this year be a mid-single digit margin business? By the fourth quarter we're starting to kind of bump around breakeven based on the size of the business being where it happens to be, which is why we've taken the strong actions we've done to restructure and reposition that business.

Noah Poponak - *Goldman Sachs - Analyst*

Got it. And then just final quick one, did aerostructures come out of the revenue outlook, or will that happen after it's a final sale?

Bill Brown - *Harris Corporation - Chairman and CEO*

We'll bring that out after we have sold the business.

Noah Poponak - *Goldman Sachs - Analyst*

Got it. Thanks very much.

Operator

Pete Skibitski, Drexel Hamilton

Pete Skibitski - *Drexel Hamilton - Analyst*

Good morning, guys. On the Exelis radio and night vision volumes, are they coming in below plan or below expectations? It looks like by my math it was down on the order of one-third or so for the first half of the year.

I'm just wondering overall is the pace of facilities consolidation, do you think that is having a negative impact on Exelis revenue overall? It just looks like everything is coming down on that acquisition sale.

Bill Brown - *Harris Corporation - Chairman and CEO*

Pete, thank you. The NVC as business we knew would be down this year. It's a little bit weaker than we thought, it's down probably in the double digits now for the year.

Early in the year when I was guiding to our original down three to five we were sizing NVCS to be down around 5% or 6% or mid-single digits. And it's gotten a little bit worse than that. Keep in mind the com system business, 75% of that is international SINCGARS radios, some of that goes into the Middle East.

So they are also being impacted by Middle East. But we had contemplated it being a weaker year. Night vision broadly is $150 million business; it's flattish versus last year.

So we're holding serve in night vision, but the com system business certainly on a year-over-year basis is down a little bit worse than we had expected. I don't think that the facility change in Fort Wayne is having any impact whatsoever on any of this transition.

Pete Skibitski - *Drexel Hamilton - Analyst*

Got it. And then just one follow up on the aerostructure divestiture, are you going to use the funds to repay debt or maybe offset dilution towards share repurchases? I think you've got about a little over $0.5 billion in debt coming due that's current debt right now, and I'm just wondering if the plan is to pay all that off, or how you're thinking about all of that.

Bill Brown - *Harris Corporation - Chairman and CEO*

Yes, our expectation is to use the proceeds from aerostructure to pay down debt is our expectation today. But we don't really see the divestiture of aerostructures to be all that material to our guidance for the year in terms of EPS. It's a couple of pennies, but it's not material.

Pete Skibitski - *Drexel Hamilton - Analyst*

Okay, thanks very much.

Operator

Seth Seifman, JPMorgan.

Seth Seifman - *JPMorgan - Analyst*

Thanks very much, good morning. I wonder we have the guidance for the segments for this year, but since they're new segments if you could talk maybe broadly, maybe this just qualitatively at this point, but how do you think about margins progressing over time for each of these segments, and where the targets are for this year relative to what you want you might like to see?

Bill Brown - *Harris Corporation - Chairman and CEO*

I think you see in the page what's happening in the margins in the guidance. We typically see quarter to quarter some fluctuations, Seth. And you saw as you went through some of the charts some sequential deterioration, some businesses have been up or down, CN was actually quite strong on a sequential and a year-over-year basis because of mix.

There was a lot of FAA work that's going in there offsetting decline in services as well as in CapRock. Things are moving around a little bit, but we'll see margins continue to improve going out into next year simply in the face of better volume and also the integration savings are going to continue to roll through, and we keep working hard to drive our normal OpEx agenda.

So we expect that we'll see margins improving. Right now I think they're pretty strong; this year in CS we're guiding to 29 5% to 30.5%, so we're holding on that. And then I do expect based on mix and the trends that we are seeing in the business that we could be towards the higher end of that.

The SIS business is a government contracting business. While it's a little bit weaker in terms of margins that we expected before, it's a pretty solid 15%, 15.5%. So that's very strong ES, at 18% to 19% is a very strong margin.

That will be impacted over time by some changes in the mix of the programs as we bring on newer programs and move off of legacy ones. So we'll see some of the integration savings offset some of the mix.

In CN, we're just battling right now what's happening in the CapRock business and services. The FA work and the international opportunities for mission networks or FA-like opportunities I think are going to help us there. So I don't want to get too far out at FY16 in terms of margin guidance here, Seth, but that's where we stand right now for within the year.

Seth Seifman - *JPMorgan - Analyst*

That's helpful color. And maybe just as a follow up, I'm not sure if we've spoken since the budget deal came out. It looked like there might be some puts and takes for particular programs, so maybe just your thoughts on that and on what we expect DoD to announce here in the coming weeks.

Bill Brown - *Harris Corporation - Chairman and CEO*

Well, I wish I had a crystal ball in what they're going to announce in the next week, but I really can't comment on that. But I think from the FY16 basis, like others in the industry have been expressing the two-year deal feels pretty good, it's good for Harris, it's good for the industry.

We see what's happening in the DoD base budget this year and next year, so it's on the upswing, at least a little bit. Which I think is very positive.

Now for Harris in particular, I think we feel very good about our programs the tactical radio line that we typically pull from are well supported. Army modernization we think is adequately covered.

The FAA looks really good, and the next-gen programs work well-funded in FY16. We're pleased to see funding for GPS III which is an important Exelis program on SV 9 and 10.

The weather programs were well supported, and I'm glad I'm here to see the recent award come through very recently on the Chris payloads for GPS III and 3 and 4. F-35, we've got a pretty large content per ship set. Again, we're seeing that ramp, that was well supported.

The additional F-18 aircraft into the budget, I think it was seven or eight aircraft, was also good because Exelis has an EW product line for the F-18. And again, finally OCO, we feel good about because of the amounts that are in there, which support some of the international FMS opportunities that we're going after in our tactical business. So overall, Seth, I think we feel pretty good about where the budget came out.

Seth Seifman - *JPMorgan - Analyst*

Thank you.

Operator

Robert Stallard, Royal Bank of Canada.

Robert Stallard - *Royal Bank of Canada - Analyst*

Thanks so much, good morning. You mentioned that some of your products and service areas have continued to go through some revenue pressures. But I was wondering in particular in say IT services for example, I was wondering if your conversations with customers and bookings have over last quarter had indicated it's getting less bad and that we can see a trough in these areas

Bill Brown - *Harris Corporation - Chairman and CEO*

On IT services, we are -- first of all it was weaker than we thought it would be in the quarter. And I think as we've been talking about probably for the last three or four quarters we've been impacted by a couple of sizable program roll offs.

We still see the overall procurement environment being relatively weak. We adjusted our full-year expectations for IT services, we came into the year thinking it would be down mid-teens, it's now down probably in the 23%, 25% range over the course of the year.

But we do see at least sequentially it stabilizing quarter to quarter going through the back end of FY16. Our book to bill in Q2 in the first half was reasonably good, it was over 1. Of course it's on a lower revenue environment, but the book to bill is pretty good.

Which again, gets us encouraged that we can support some stability in the back half. We also have incumbent positions on some legacy programs that as the roll offs start to ease, I think we'll see more stability in the back half.

So for the pipeline that we have, we've got a very large pipeline of opportunities that we are chasing. It's actually come up a couple billion from the beginning of the year. It's something like $24 billion now.

We have -- within Harris we've got to make sure that we're -- we improve our win rate. Our win rate is a little bit below what our target happens to be. It's -- we typically win in the 23%, 25%, it should be 30% or more.

So we're not winning quite as much as we need to be. A lot of that's really around our front-line execution and our process execution and we're getting that fixed. So I do think that part of this is a slow environment and part of it is what we need to do to improve our own win rate internally within the Company.

Robert Stallard - *Royal Bank of Canada - Analyst*

Right. And then maybe a second question, you mentioned the manpack and the DoD's timetable to get this done in Q1. Assuming they stick to that, assuming you win something, when could the revenues from this award start to flow through?

Bill Brown - *Harris Corporation - Chairman and CEO*

We're not expecting revenue opportunities to really hit us until really going into FY18. It will be for a production, if they stick to the current schedule, I believe it's in the middle of 2017, calendar 2017. So around June, which really means more significant revenue would impact our FY18 not FY17.

Robert Stallard - *Royal Bank of Canada - Analyst*

That's great, thanks so much.

Operator

Carter Copeland, Barclays.

Carter Copeland - *Barclays Capital - Analyst*

Good morning, guys. Bill, I wanted to hit on the comments you made about the aerostructures divestiture and the dispassionate approach you mentioned in your prepared remarks on the portfolio.

I know you're probably right on about the time of the year where you're putting together the first strategic plan as a combined company and sort of wondering what qualifies the strategic and non-strategic at this point? Maybe just give us an update on how you think about what the various hurdles are to make a business strategically valuable to what you want Harris to look like with Exelis in it as a combined entity?

Bill Brown - *Harris Corporation - Chairman and CEO*

Well, that's a very good question, Carter, and you're right, we are getting into our strategic planning process and that will inform a little bit more on what sort of portfolio we want over the long term. And as I rarely comment about any specific business, but at the end of the day a couple of things I would share with you.

One, we are a technology-based company. We invest in new product development and we want to use technology to differentiate offerings in the marketplace. So one of the key things that I look for are the things that the businesses that we want to be in should be able to be differentiated by providing some technology.

We are also a mission-critical communication defense electronics type company. So for the aerostructures business we've got these large composites skins and large factories with a lot of capital intensity, it really didn't necessarily fit with the rest of what we look like. So I think that one, as we came into the year and we're looking hard at which businesses should Management focus it's time and attention on, on a continuum of businesses that go from very, very strategic like tactical radios on the far left to maybe the less strategic on the far right being aerostructures.

Other businesses sit in the middle, and I'm using the criteria that I've just described to assess which ones we should keep and which we should not. At the end of the day does it fit strategically? Is it more valuable to us versus to somebody else? We look at performance of the Company, performance of the business, all of those factors come into play in determining which ones we should keep and which ones we should not.

Carter Copeland - *Barclays Capital - Analyst*

Do you have a bias either government versus commercially leaning at this point, or its agnostic to that?

Bill Brown - *Harris Corporation - Chairman and CEO*

We're pretty agnostic. It's more about what businesses should we be in that we can bring some value to end customers, where we can apply technology, where we can differentiate our offering, where we can gain market share through differentiated offerings. All of those develop -- generate a very satisfactory return on investment and those businesses, those are the things that we're looking at. And they could be commercial or government. We see a big part of our business today is on the government side, we're very good at that, but that doesn't really drive the decision at the moment.

Carter Copeland - *Barclays Capital - Analyst*

Great. And just a couple of final clarifications. On the space and intel margin revision, I wondered if you could give us some detail on what drove that since the revenue base is unchanged. And just some clarification on what you meant by bandwidth consolidation at CapRock, and what that was meant to accomplish? Thank you.

Bill Brown - *Harris Corporation - Chairman and CEO*

On the space and intel side really it's just a shifting mix of what's in the business. Slightly more cost plus than fixed price contracts, and we're seeing some of the new starts and new wins that space and intel are getting are coming in at slightly lower margin.

So we just adjusted down to reflect that there's nothing structural in that business that's causing it. On the CapRock side, it's pretty remarkable the amount of bandwidth that's being consumed by the cruise industry and our expectations for where that's going to grow over time.

It is growing very, very quickly. And with a very significant change in the supply structure of bandwidth satellite bandwidth, we are able to use that leverage to both negotiate better deals, better pricing, and globally consistent pricing so that we don't have for different types of satellites for different customers in different region very different pricing. We're looking for pricing uniformity. And that helps us run our business a little more efficiently and effectively. And that's where we are heading on the bandwidth deal. So thank you for those questions, Carter.

Carter Copeland - *Barclays Capital - Analyst*

Thanks, Bill.

Operator

Josh Sullivan, Sterne CRT.

Josh Sullivan - *Sterne CRT - Analyst*

Good morning. With public safety potentially turning a corner here, Bill, could you provide a little color on Harris's position with the first net RFP? Are you teaming with anybody, does it matter? Can Harris sell equipment to anybody who wins? Just a little color on that RFP and how Harris is positioned

---

Bill Brown - *Harris Corporation - Chairman and CEO*

Well thank you, Josh. The RFP is out, which is good. We've been tracking this for several years and I think it's good news that it's out. We've met with the first net board a couple of different times, and we are pleased to see it out there.

There's a process that they've laid out, I think it's a little bit on the aggressive side, there's questions and capability assessments that are due coming up here in February and March. Bids are due on I think the 29th of April if they don't get extended.

My expectation of what comes out in the RFP is a June award, a preliminary award in June and then it goes to the state consultation period for 90 days where the states have an opportunity to opt in or opt out. And then after which whoever it is, the preliminary award winner would resubmit a new bid and with a final award by November of 2016.

So that to me is a pretty aggressive timeline. I think the RFP, Josh, feels like it's geared more towards commercial carriers as primes just by the way it's written in some of the requirements in the RFP.

We are as Harris still assessing the role that we're going to play. Since it's a live competitive procurement I don't think we want to talk more about that, but we're in the middle of assessing the way at which we want to participate in what could be a very interesting long-term opportunity that transforms the public safety networks in North America.

Josh Sullivan - *Sterne CRT - Analyst*

Okay, thank you.

Operator

Chris Quilty, Raymond James.

Chris Quilty - *Raymond James & Associates, Inc. - Analyst*

Thanks. Question, it looks like the GPS OCX contract may come up for rebid. Can you talk about how that might impact you either positive or negative?

Bill Brown - *Harris Corporation - Chairman and CEO*

Well we're watching it very carefully, Chris. We are working diligently to support our prime customer, which is Raytheon. Raytheon is the prime OCX, and I think you've read a lot in the press about some the challenges in that program, really around cyber security protections which are causing the development timeframe to go quite long.

And obviously it's got a lot of attention on the hill with general heightened with Secretary James and a lot of people that are focused on this as the team at Raytheon. And we're working diligently to support Raytheon in their programming, getting them back on schedule, at least holding to the schedule they have articulated. Really not much more to say at this point on that.

Chris Quilty - *Raymond James & Associates, Inc. - Analyst*

And do you feel Harris' performance on that contract has been up to par?

Bill Brown - *Harris Corporation - Chairman and CEO*

It's a legacy Exelis program, we're both on the payload for GPS III. So we're on the payload side as well as on the ground site supporting Raytheon. And our understanding is our team is performed well. We bring good systems engineering capability, and I think we performed well to our customer, but I don't think I would suggest we'd say more than that.

Chris Quilty - *Raymond James & Associates, Inc. - Analyst*

And I think Exelis has also had some issues on the GPS payload side. Where do you stand in terms of resolving those issues?

Bill Brown - *Harris Corporation - Chairman and CEO*

Yes, this was a very complicated payload. It's a very difficult one, and the requirements were quite stringent, maybe they weren't fully understood many years ago when Exelis wanted, it was very late. It got a lot of attention under Exelis they deploy a very good team [at it] just towards the end when we were buying the company.

We have also deployed experts into the Clifton facility, half a dozen or a dozen very good people on manufacturing operations, design engineering, a lot of different things. And there's been I think very good progress here, made over the last 6 to 9 months.

And over the holidays, just before the holidays, the very first space vehicle, SP1 with our payload came out a thermal vac early with very, very good performance. And it was I think it's a fantastic a competent by Lockheed, by our team, by the Air Force, and we're all very proud of that.

And I think that puts us on a really good trajectory on GPS III on the space side and it gives us more confidence with Lockheed that SV-9 and 10 should get awarded sometime this government fiscal year. So I think our performance has improved pretty, pretty much here, Chris.

Chris Quilty - *Raymond James & Associates, Inc. - Analyst*

Great, thank you.

Pamela Padgett - *Harris Corporation - VP of IR*

Thank you, Chris. And with that last question Bill has a few wrap-up comments and then we'll close down the call.

Bill Brown - *Harris Corporation - Chairman and CEO*

Okay, well thank you, Pam. And before we end the call I want to take this opportunity to let you know that Mick Lopez has decided to leave Harris for personal reasons to pursue new opportunities outside the Company. As you know, these last two years with Mick as CFO have been truly transformative for Harris with the signing, the closing, the financing of the largest acquisition in our Company's history. And I want to thank Mick for his leadership and his many contributions to Harris over the last two years, Mick. So thank you for that

---

Mick Lopez - *Harris Corporation - SVP and CFO*

Thanks to you, Bill. I really appreciate your kind words.

Bill Brown - *Harris Corporation - Chairman and CEO*

So succeeding Mick will be Rahul Ghai. Rahul has led our finance integration team since March of 2015.

Rahul has a diverse finance background, with experience in both commercial and aerospace industries, including executive leadership roles at both Aetna as well as United Technologies. A press release with more details will be issued momentarily.

Please join me in wishing Mick well in his future endeavors, and also in welcoming Rahul to Harris as our new Chief Financial Officer. So as usual Pam will be available throughout the day to address any additional questions that you might have, and I want to thank you again for joining our call today. So thank you.

Pamela Padgett - *Harris Corporation - VP of IR*

Thank you, everyone. Let me know how I can help.

Operator

Ladies and gentlemen, this concludes today's conference. Thank you for your participation and have a wonderful day.
