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HRS - Q3 2018 Harris Corp Earnings Call

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OVERVIEW:

Co. reported 3Q18 non-GAAP EPS of $1.67. Expects FY18 revenue to grow about 4% and EPS to be $6.45-6.50.

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CORPORATE PARTICIPANTS

Anurag Maheshwari *Harris Corporation - MD of Asia-Pacific*

Rahul Ghai *Harris Corporation - Senior VP & CFO*

William M. Brown *Harris Corporation - Chairman, President & CEO*

CONFERENCE CALL PARTICIPANTS

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

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

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

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

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

Peter John Skibitski *Drexel Hamilton, LLC, Research Division - Senior Equity Research Analyst*

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

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

Seth Michael Seifman *JP Morgan Chase & Co, Research Division - Senior Equity Research Analyst*

PRESENTATION

Operator

Greetings and welcome to the Harris Corporation Third Quarter Fiscal Year 2018 Conference Call. (Operator Instructions) As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Anurag Maheshwari, Vice President, Investor relations. Thank you. You may begin.

Anurag Maheshwari - *Harris Corporation - MD of Asia-Pacific*

Thank you, Michelle. Good morning, everyone, and welcome to our third quarter fiscal 2018 earnings call. On the call with me today is Bill Brown, Chairman and Chief Executive Officer; and Rahul Ghai, Senior Vice President and Chief Financial Officer.

First, a few words on forward-looking statements. Discussion today will include forward-looking statements and non-GAAP financial measures. Forward-looking statements involve assumptions, risks and uncertainties that could cause actual results to differ materially from those statements. For more information, please see the press release, the presentation and Harris' SEC filings. A reconciliation of non-GAAP financial measures to comparable GAAP measures is included in the quarterly materials on the Investor Relations section of our website, which is www.harris.com, where a replay of this call also will be available.

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

William M. Brown - *Harris Corporation - Chairman, President & CEO*

Well, thank you, Anurag, and good morning, everyone. Earlier today, we reported strong third quarter results, with a non-GAAP earnings per share of $1.67, up 21% on 5% revenue growth. Revenue was up in all segments, and operating margin expanded 30 basis points to 19.3%. These results extend our strong year-to-date performance, with non-GAAP earnings per share over the first 3 quarters up 17% on 4% revenue growth and 10% higher free cash flow.

The highlight, again, this quarter and for the year is our strong quarter momentum, up 27% in the quarter for our fourth consecutive quarter of double-digit orders growth. Book-to-bill was 1.2 for the quarter and the year, with total company backlog increasing 22% over last year.

So let me start by providing some color on top line growth drivers across the segments noted on Slide 4. Communication Systems revenue grew 4% in the quarter, driven by strong growth in DoD Tactical Communications and night vision. DoD Tactical delivered another solid quarter, with revenue up 48%, as the focus on readiness continued to drive growth across the services, especially the Air Force and the Army, as they upgrade their legacy communicating equipment to software-defined radios. This sustained readiness in demand has driven a year-to-date increase in DoD orders of 62% and revenue growth of 32%, and we now expect DoD revenue to be up about 30% versus prior expectation of low 20% growth and up from mid-teens when we started the year.

International Tactical revenue was down 12%, as expected, on a tough year-over-year compare, as Q3 '17 included a record $150 million of Eastern European revenue. The decline in Eastern Europe was partially offset by continued momentum in the Middle East and Africa, driven by ongoing counterterrorism support and by the ramp of these Australian modernization program in the Asia-Pacific region. Strong orders growth of 15% for the quarter and 36% year-to-date have nearly doubled International backlog, providing more visibility going into the fourth quarter and next year. For the year, we still expect international will be flat to slightly down.

As we've been communicating, our tactical strategy is to win all DoD ground radio programs, leverage platform investments to maintain international leadership and expand our addressable market into network systems, ISR and airborne. And we continue to execute well against this strategy with several wins and accomplishments this quarter. On DoD ground radios, Army and SOCOM modernization programs continue to make solid progress. In the omnibus bill, the HMS program is well funded at $415 million in GFY '18, more than 50% higher than the prior year and up an additional $60 million over the original GFY '18 president's budget request. We delivered additional HMS Manpack test radios in the third quarter and earlier this week, we received an LRIP delivery order from the Army to proceed with the next production phase for the Manpack radio, clearly demonstrating the Army's commitment to the program.

On the Army 2-channel handheld radio, we expect to deliver the first batch of test radios soon with an award anticipated sometime this summer.

For the SOCOM 2-channel handheld, we delivered additional test radios during the quarter, and we'll ramp production in the fourth quarter, accelerating in fiscal '19.

Continuing our effort to expand into broader network systems, we recorded another win in Asia when we leveraged our radio incumbency position and were selected as the prime systems integrator to modernize and upgrade the military communications network. This builds on prior successes in Australia, UAE and other Middle Eastern and Central Asian countries, as we continue to expand our aperture and increase customer stickiness.

And then finally, just a few days ago, we were awarded a 5-year, $130 million sole-source IDIQ by the Air Force to develop and produce a handheld video data link device to provide airborne-collected ISR information to forces on the ground, opening a new market opportunity for us. This strategic win against the incumbent helps us increase our share wallet of ground devices and positions us well to grow in the airborne ISR segment going forward.

Overall, for the first 3 quarters, tactical revenue increased 7%, with a book-to-bill of 1.4, resulting in a 74% year-over-year backlog increase to $880 million. This growth in tactical, coupled with another strong quarter of double-digit growth in Night Vision, has enabled us to raise Communication Systems revenue guidance to an increase of 7% to 7.5% for the year versus the prior guidance of 5% to 7% and 3% to 5% when we started the year.

In Electronic Systems, revenue growth accelerated to 10% for the quarter, with growth across all ES businesses, as the first half ADS-B headwind subsided. This strong growth was driven by long-term platforms like the F-35, the F-18 and F-16, which collectively grew more than 25%, as we leveraged technology upgrades, ramped production and expanded our international footprint.

In Avionics, we continue to generate double-digit growth in weapons release systems, even excluding F-35 growth, with new content awards and increased production of both domestic and international platforms. Segment order growth accelerated in the quarter to 56% for a book-to-bill of 1.4, and orders are now up 32% on a year-to-date basis. We booked more than $300 million in orders across F-35, F-18 and F-16 platforms, including a $184 million contract supplying electronic jammers to protect U.S. Navy, Australian and Kuwaiti F-18 aircraft against electronic threats. Orders across the 3 platforms, F-35, F-18, F-16, have more than doubled this year to over $900 million and are on track to hit $1 billion for the year.

Overall for ES, solid third quarter results have mitigated the first half ADS-B impact, with year-to-date revenue now up 4% and a book-to-bill of 1.3, resulting in a backlog increase of 21%. This, combined with an $18 billion opportunity pipeline and $4 billion of proposals outstanding, gives us confident that revenue will grow 4.5% to 5% this year and that the growth will accelerate in the medium term.

In Space and Intelligence Systems, revenue was up 1%, as Classified programs continued to grow mid-single digits from the ramp-up of smallsat, ground-based adjacency and space surveillance programs, offset by expected headwinds on environmental programs.

Order momentum also remained strong in the Classified area with additional customer funding for long-standing programs in new adjacencies. In addition, we were awarded an approximately $500 million multiyear contract to provide payloads for an exquisite classified space system, reflecting continued success in leveraging technology to not only expand as a full-mission solution partner in smallsats, but also to strengthen our position as a partner of choice on large exquisite platforms.

I'm also pleased to note a few accomplishments that strengthened our competitive position on important missions.

In the Environmental Solutions business, the launch of NOAA's GOES-S satellite in early March included our second advanced baseline imager, or ABI, which improves fire detection and severe weather forecasting. This follows a successful launch of GOES-R in November of 2016, which has provided unprecedented imagery of recent hurricanes, with 4x the resolution and 5x the download speed, providing forecasters with 30-second updates of the entire Western Hemisphere. Harris' ABIs are also on last 2 of NOAA's latest generation of geostationary weather satellites, GOES-T and GOES-U, with the entire constellation controlled by Harris' enterprise ground system.

We continue to execute well on GPS, with a proven and reliable production cadence that included delivering a fifth GPS III navigation payload in early March, 26 days ahead of schedule. Strong execution along with a developed and fully tested 100% digital mission data unit positions us well for the upcoming GPS III 11+ award. Year-to-date, Space and Intel revenue was up 1%, and orders were up 6%, resulting in a book-to-bill of greater than 1. Our pipeline has grown by 14% to $13 billion over the past year and with the recent successes of expanding into new adjacencies, we're confident this business can be a growth driver in the medium term.

In summary, with our strong year-to-date performance, continued order momentum and an improved outlook on the back of a favorable GFY '18 budget resolution, we're tightening our fiscal '18 guidance and now expect revenue to be up approximately 4% from the previous guidance of 3% to 4%. This growth, combined with our strong operating performance, gives us confidence to tighten our EPS guidance to $6.45 to $6.50 at the high end of the previous range and increase free cash flow to a range of $900 million to $925 million.

And with that, let me turn it over to Rahul.

Rahul Ghai - *Harris Corporation - Senior VP & CFO*

Thank you, Bill, and good morning, everyone. Starting with total company results on Slide 5. As a reminder, statements today are on a non-GAAP basis and exclude onetime adjustments.

Revenue was up 5% in the third quarter with growth across all 3 segments.

Operating income was up 7% on higher volume and operational efficiencies, resulting in margin expansion of 30 basis points to 19.3%.

EPS grew 21% and was up 12% excluding the benefit of tax reform.

Adjusted free cash flow was $121 million, as higher revenues and order momentum in the back-end of the quarter resulted in $120 million increase of receivables and inventory, which will unwind in the fourth quarter.

Year-to-date revenue was up 4%, and operating income was up 3%, despite a $36 million unfavorable impact from the ADS-B program transition in the first half of the year.

Year-to-date adjusted free cash flow was $451 million, a 10% increase over the prior year as we enter our strongest cash-generation quarter.

We have returned a total of about $400 million to shareholders, including approximately $200 million in share repurchases. In addition, we prefunded the pension by $300 million in the third quarter. On a last 12-month basis, adjusted free cash flow was about $900 million.

Turning to the third quarter EPS bridge on Slide 6. EPS grew by 21% or $0.29. Of this, $0.11 of EPS growth came from higher volume in Tactical radios, Avionics and Classified space, solid program execution and higher pension income. This was partially offset by lower environmental volume and increased R&D investment. Lower share count and reduced interest expense contributed $0.06.

Lastly, a lower tax rate, including the benefit from tax reform, added $0.12 to EPS growth.

Segment details on Slide 7. Communication Systems third quarter revenue was $481 million, up 4% versus the prior year. In addition to strong growth in DoD Tactical, Night Vision revenue was also up double digits, as the business continued to improve execution and increase its share of wallet with the Army. Operating income for the segment was up 5% to $147 million, and operating margin expanded 20 basis points to 30.6% on higher volume.

Orders grew for the seventh straight quarter, up 20% with a book-to-bill of 1.1. In addition to strong bookings in Tactical, PSPC orders grew 28% on increased demand for legacy system upgrades from state and local agencies.

Night Vision orders grew 10%, with continued momentum from the U.S. Army, and we received a $30 million award to support increased logistics readiness. Year-to-date segment revenue increased 6%, and operating income was up 8%.

Operating margin of 29.6% was up 50 basis points versus the prior year. Year-to-date segment orders have increased 36% with a book-to-bill of 1.3 and it's greater than 1 in all 3 businesses in this segment: tactical, PSPC and Night Vision. We continue to include historical information for tactical orders, revenue and backlog as supplemental information at the end of this presentation.

On Slide 8. Electronic Systems revenue was $609 million, up 10% for the quarter. In addition to the growth in Avionics and electronic warfare, that Bill mentioned, we saw solid revenue increase from the ramp of U.K. robotics and UAE battle management programs. Segment operating income declined $3 million and higher volume was more than offset by increased R&D investment and program revenue mix. Year-to-date segment revenue was up 4%, and operating margin was down to 18.6%, as operational efficiencies partially offset the negative impact of the ADS-B program, R&D investment and program revenue mix.

On Slide 9. In Space and Intelligence Systems, segment revenue was up 1%, and operating income was up 8%, as margins expanded 100 basis points from strong program execution and higher pension income. Year-to-date segment revenue was up 1% with continued growth in Classified programs offset by a decline in environmental revenues. Operating margin expanded 120 basis points to 17.7%.

Moving to Slide 10 for full year guidance. As Bill indicated, given our strong year-to-date performance, we now expect revenue to be up about 4% for the year, reflecting strength in DoD Tactical and Avionics. We're tightening the EPS guidance at the high end of the range to $6.45 to $6.50 from drop-through on higher volume. Tax rate guidance is now 22.5% from 23% previously. The $0.04 benefit from lower tax rate will be offset by higher-than-expected share dilution and an increase in interest expense from the additional debt raised for pension-free funding.

In Communication Systems, we are increasing the revenue guidance to be up 7% to 7.5% versus up 5% to 7% previously from improved DoD Tactical outlook and Night Vision readiness demand. In Electronic Systems, we're narrowing revenue guidance to the higher end of the range to be now up 4.5% to 5% versus up 4% to 5% previously, as strong orders in Avionics convert to revenue.

In Space and Intelligence, we're narrowing the revenue guidance to be up approximately 0.5% versus flat to up 1% previously. For each segment, margins are still expected to be around the midpoint of the guidance ranges at about 30% in Communication Systems, 18.5% in Electronic Systems and 17.5% in Space and Intelligence.

We are increasing the adjusted free cash flow guidance from approximately $900 million to a range of $900 million to $925 million due to higher earnings.

And with that, I would like to turn it back to Bill for closing remarks.

William M. Brown - *Harris Corporation - Chairman, President & CEO*

Well, thanks, Rahul. We're now in the innings of fiscal '18, and we feel good about our year-to-date results and our expectations for the balance of the year. The passage of the GFY '18 omnibus bill and the trend line in the President's budget in '19 and beyond are real positives for Harris and the programs we support, especially in strategic growth areas where we've invested in R&D over the past several years and have strong customer positions.

Tactical radio budgets have increased by an additional $1 billion over the next 5 years compared with where they were this time last year. F-35 and F-18 aircraft quantities have been increased, Classified space and other IC budgets are trending up, and the FA programs are well funded. Overall, our bid and proposal activity remains high, our win rates are solid, and our order rates -- our orders in backlog continue to grow, setting us up for accelerating growth in '19 and in the medium term, as we execute against our strategic priorities and deliver shareholder value.

And with that, I'd like to ask the operator to open the lines for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Seth Seifman with JPMorgan.

Seth Michael Seifman - *JP Morgan Chase & Co, Research Division - Senior Equity Research Analyst*

I wonder -- Bill, maybe if you could talk a little bit about -- I think, overall, the boost in the budget was much higher than expected, and a lot of it comes in areas that should be attractive for Harris. And so when you think about the framework for growth, kind of the multiyear framework that you guys outlined, is it possible at this time to think about how much acceleration there might be relative to that framework?

William M. Brown - *Harris Corporation - Chairman, President & CEO*

Yes, Seth, thanks for the question. The -- for us and for everybody in this space, the budget was very positive. As I mentioned in my remarks, Tactical radios is pretty good. We see addition aircraft quantities, and we're very encouraged about the trend line on the intelligence budgets, including areas that we've been able to stake a position, like in smallsats. So we're very encouraged by that. At the beginning of the year, we set out a framework, which showed mid-single-digit growth across the medium term. And while we're not providing any guidance today, I see it today being incrementally better than when we started the year. And you can see that in, sort of, the trend lines, based on what we've seen over the course of our fiscal '18. In CS, we started the year at 3% to 5%, we went to 5% to 7%, now we're at the 7% to 7.5% range. DoD Tactical, we started the beginning of the year at mid-teens, we went to 20% growth year-over-year, now we're about 30%. We're seeing much greater traction in the electronic warfare and Avionics segments. So when I sit and look at it, it feels better incrementally than it did before, so maybe mid-single digits plus in '19 and beyond. Clearly, the CS segment, we said was, at the time, I think, mid-single digits is probably mid to high. I think Electronic Systems was mid to high, and it's probably at the high end of that. And I would say, also on the Space and Intel business, which, we were thinking, was low- to mid-single-digit growth at the beginning of the year, feels closer to mid-single-digit growth, principally because of getting the traction in smallsats as well as the very significant win that we recently received in the -- on an exquisite payload. So that all is also very encouraging, and I see it's being a bit incrementally better in '19 and beyond than we thought at the beginning of the year.

Seth Michael Seifman - *JP Morgan Chase & Co, Research Division - Senior Equity Research Analyst*

That's great color. And Rahul, if we ended the year today, what would happen to the pension income in fiscal '19?

Rahul Ghai - *Harris Corporation - Senior VP & CFO*

For every 25 basis points of increase in rates, it reduces our pension income by about $8 million to $10 million. And the [10-year] is up about 50 basis points since we set the rates in June. So there is some headwind from increase in rates. However, we did make a voluntary contribution of $300 million to our pension fund that will generate 7 3/4% rate of return, and it should also reduce our PBGC premiums. So while the increase in rates will be a headwind, we should be able to manage through that, and the benefits of incremental contributions will more than offset it. But it will all depend on where the rates are as of June 30, but we don't see any year-over-year change in our pension income at this point.

Operator

Our next question comes from the line of Rob Spingarn with Crédit Suisse.

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

Bill, the Army has been restructuring its network, and I'm wondering if you can talk about, on a forward basis -- I'm talking beyond the existing business, the radios and so forth. But what interactions Harris is taking with the network cross-functional team at the Army? What kind of IRAD investments are you making?

William M. Brown - *Harris Corporation - Chairman, President & CEO*

Well, it's a good question, Rob. We've -- we're very tightly partnered with the Army and have been for quite some time. As you know, they're forming this Futures Command. There's fixed investment modernization priorities or 8 CFTs, or cross-functional teams, one of which is on the Army network. We're very closely linked to them. They've been to our facilities. We have detailed conversations with them, and they help us think through how we can invest our IRAD spend, both on radio, but probably more importantly, on next-generation waveforms that are low probabilty of intercept, low probability of detection, anti-jam waveforms that can operate effectively in contested environment. So we're very tightly linked with them. As you know, they've decided to separate the decisions around the upper tactical network, which is around WIN-T. We've got a radio and a waveform that's positioned there from the lower tactical, which is around the radios. And I'm very pleased to see them moving forward and placing orders for the Manpack. They're moving forward on the handheld. I think it's all very, very encouraging. So one way of saying we're very tightly connected. And I think we continue to adjust and adapt our strategy and our investments, given where the Army happens to be moving.

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

Do you see the competitive environment changing here? Are any of your competitors withdrawing, perhaps, giving you, essentially, an opportunity for a larger share of everything?

William M. Brown - *Harris Corporation - Chairman, President & CEO*

Well, it is shifting around. I mean, through the JTRS program, we had one of our large competitors in this space dropped out. One of their partners has a particular role on a program. There's another that's a competitor on the low-end radio, or the handheld radio. We're sole-source on the SOCOM opportunity. There's different players that are evolving and developing unique waveforms that are getting some traction in certain parts of the DoD community. So yes, it's shifting around. But I feel really good about our competitive position. We've been able to sustain high share in this area and high margins in this area, despite the shifts that are occurring across the services between DoD and international with some new competitors in, older competitors out. I think we continue to, kind of, keep the course and invest heavily, and I think we'll end up continuing to be successful in this area.

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

Okay. And then, just this is a little bit based on Seth's question a moment ago, a high-level question. But given the budget environment and the fact that we've got a pretty clear look at the -- given '18 and the '19 budget, how do you think about industry growth for defense for the next, call it, 3 years? Is there an average kind of top line growth number we can think about?

William M. Brown - *Harris Corporation - Chairman, President & CEO*

I really don't think about where the average industry growth is. But everybody, individually, is going to be affected in a different way. Harris -- even within Harris, we've got some shorter-cycle and some longer-cycle businesses. But I think, overall, it's going to be positive. The budget trends are clearly up, at least for the next several years. It all depends on how fast the appropriations get flowed down into contracts and awarded to companies, and how fast they can execute on it. So there's lots of dimensions here that are going to drive top line growth, including making sure that all of the things you need to provide to satisfy that contract, the supply chain, your own asset structure, your own employment, all needs to adapt to a much better budget environment. But I think, overall, it's clearly a positive sign, and most companies, including Harris, will be up in the mid-single digit plus range, '19 and beyond.

Operator

Our next question comes from the line of David Strauss with Barclays.

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

So wanted to ask about CS margins. You had a little bit of year-over-year improvement, nice sequential improvement. Looks like in Q4, despite forecasting higher revenues year-over-year, you're guiding to down margin. Just, if you could walk through the different moving pieces there, and how I might set up for margins in 2019 on the growth that you're talking about.

Rahul Ghai - *Harris Corporation - Senior VP & CFO*

Sure. So David, this is Rahul. So the margins for CS, -- we've -- it's been really good year-to-date. Last year, we were at 29.1% through the first 3 quarters. This year, we are at 29.6%, so up 50 basis points, and so really strong growth year-to-date. And there is, typically, a step-up in the fourth quarter on the margin side in Communication Systems, and we -- last year, it was a -- this year, same thing, we're expecting a slight step-up from where we are year-to-date. And that's going to come from increased volume and some mix shift of product. So we feel good about the approximately 30% that we've kind of guided to this year. Now going forward, there are a few things that will drive CS margins. But overall, we feel that we can see around the 30% range. The -- there should be benefit from higher volume and as that drops through to the factory. But the modernization products are coming with slightly lower margin, and there's -- all the systems wins that we're getting, they also typically come in at less than the product gross margins. So you put that all together, and you feel that 30% is a sustainable rate for this segment.

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

Okay. And where -- any update on where you are in terms of the capacity utilization in Rochester?

Rahul Ghai - *Harris Corporation - Senior VP & CFO*

Sure. Our capacity utilization is around 60% in the factory right now.

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

Okay. And Rahul, a follow-up on working capital. So you've had some working capital growth this year but below the level of your sales growth. How are you thinking about working capital from here, either as a percentage of sales or days working capital, where do you think that can get to?

Rahul Ghai - *Harris Corporation - Senior VP & CFO*

Yes. So we've done well with working capital, David. I mean, when we bought Exelis, Harris was around mid-40s. Exelis was well north of 80%, whatever -- sorry, 80 days. And -- so combined, we were probably in the 60-ish range, 60 days range. So we -- last year, we ended at about 43 days. And that was 6 days lower than where we ended fiscal '16. So we've shown sequentially better working capital improvement. And this year, we're targeting about a 2-day improvement in working capital. So we think we'll end around 41 days. The opportunity for us, going forward, is around 2 areas: one, advance payments. Our advance payments are typically much lower than industry average, so we see there's an opportunity to improve that, and reducing our inventory. We've done well so far but there's incremental opportunity. So it's not going to be -- we're not going to see another 6-day reduction. But there is an opportunity to bring that down under a couple of days over the next 2 to 3 years. So we'll keep making progress on working capital.

Operator

Our next question comes from Noah Poponak with Goldman Sachs.

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

Bill, should it be in my scenario analysis, not my base case, but in my range of potential outcomes of what is spinning out of my model, that total company organic revenue growth next year is 10%?

William M. Brown - *Harris Corporation - Chairman, President & CEO*

It's certainly not what we're guiding to today. We're not providing guidance to '19. But it -- again, it all comes down to how fast the budget plus-ups that we've seen and the higher budget in '18 flows onto contract vehicles. We have seen, very fortunately, the Army move a little bit faster than we had expected on the HMS Manpack. Receiving the delivery order this week was a good positive. I think they were indicating, previously, it would be, perhaps, mid-summer. So they're moving faster on that. That will deliver in '19. That's a good sign. But I think, Noah, it all comes down to how fast money can flow in the contract vehicles, and then how fast we can execute on that. So that -- there's a scenario out there that gets you higher than we're at today at mid-single digit plus in next year. But what we'll tell you more about that, once we close our fourth quarter in -- at the end of June and provide some guidance in late July or early August.

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

Okay. With ES being up 10% organically in the quarter, but you're simultaneously spending some incremental R&D there, making some new investments there, is there a correlation between that growth rate and the investments? Or is the growth rate today from business already secured, and the investments you're making now are hoping to win you more new business beyond today?

William M. Brown - *Harris Corporation - Chairman, President & CEO*

I mean, they don't correlate on a day-to-day or month-to-month basis. But clearly, the investments we've made over the last few years in a couple of areas, certainly, in electronic warfare, we've talked about that at quite some extent, is really paying a lot of dividends as well as investments in a variety of technologies in the Avionics side, especially in open-mission systems, and that's paying some dividends. So we're starting to see that flow through in the order rates in the revenue in Avionics and electronic warfare. And I would expect, as we continue to invest, that we've stepped up very recently again, even from where we were before in investments in these areas. And I think that will help us in '19 and beyond. There's some -- also some franchise we're investing in. That includes robotics. We've seen some -- a very important win. That contract in U.K. is executing, and we see a lot of opportunities to grow from that. So there is a correlation between the step-up in the investments we've made over the last few years in IRAD and the growth rate today. But I'd say what we're spending on today is going to help us in '19 and beyond.

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

Got it. And then just one more on the international piece of Tactical radio in com systems, your tone maybe sounded a little more positive there, speaking to what the backlog is. And I know you've talked about that being flat to down this year, and I then think, maybe refresh my memory, but I think you've, kind of, said maybe flat or maybe even down slightly, again, next year, just because you had the European recap that's -- takes more than a year to normalize. But are you now thinking international can grow in '19? Or what's the latest view there?

William M. Brown - *Harris Corporation - Chairman, President & CEO*

Yes, we -- I mean, we -- again, we haven't given any guidance in '19. But there are certain things that we're looking at that would indicate that the international business can grow modestly in '19. Right now, we're in fiscal '18, we are still guiding to flat to maybe down slightly. That implies a growth quarter in Q4. What we have seen this year different than last year in the prior years is less lumpiness. It's more level loaded and even loaded across the quarters, which is good. We always see Q4 being a bit stronger than the others but a little more even loaded. Our pipeline -- despite the good order rate that we've seen so far this year, our pipeline remains very robust at about $2.3 billion. It's about the same as it's been every quarter over the last year practically. So even though the orders are coming up, the pipeline is replenishing itself relatively quickly, and we feel good about the position that we happen to have. So I think we'll deliver Q4. And as we get into '19, we'll give a little bit more guidance on that. But I don't see a step-down in fiscal '19 in international. If anything, it will be probably slightly up.

Operator

Our next question comes from the line of Jon Raviv with Citi.

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

I was just wondering if you could expand on David's question about margins, just in a growth environment, you're talking about some potential acceleration in each segment. How do you think about mix, R&D spending investments, in each segment going forward? We understand that CS stays around 30%, but how about for the other 2?

William M. Brown - *Harris Corporation - Chairman, President & CEO*

Yes, I mean -- I think we're looking at margins being about flat in the next year or so in each of the segments. So CS, around 30%, and the others about where we happen to be guiding to in fiscal '18. But as my comments on mid-single-digit growth plus over the near term, clearly, CS and ES are going to be growing a little faster than the Space and Intelligence business. So the businesses with slightly higher margins and higher margins, certainly in the CS side, will grow faster. So at the company level, going into '19 and beyond, and just because of the mix across the franchise, across the company, we could see some margin growth at Harris, overall, in '19 and beyond.

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

Understood. And do you care to update us on just thinking about multiyear free cash flow targets in terms of dollars in light of, again, better budgets or some of the working capital [offers] that you highlighted?

Rahul Ghai - *Harris Corporation - Senior VP & CFO*

So our guidance this year -- the revised guidance is about $900 million, $925 million. So to get on these kind of -- we see a path to get to $1 billion next year. And that $85 million to $90 million, several puts and takes. About tax reform, it's probably half of that growth. So we've got, since we are a fiscal year company, in kind of June fiscal year, we got a half benefit of tax reform this year, the remaining benefit coming next year. So there is a tax reform benefit next year. And then we have about $15 million to $20 million of cash outflow from Exelis integration in fiscal '18. That should wind down by '19. And there'll be incremental benefit from increased earning. So there's a clear line of sight to getting to $1 billion by '19. And then beyond that, where cash flow should grow with earnings, there is -- we do see opportunities on working capital improvement, and we'll deal with that when we get there in terms of how that all mix changes between revenue growth and working capital. But we see line of sight to $1 billion next year and then grow through the earnings beyond that.

Operator

Our next question comes from Gautam Khanna with Cowen and Company.

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

I was hoping that you could expand upon your comments on the pipeline. You mentioned the $2.3 billion on the foreign side tactical RF. What are the big opportunities, if you could maybe give us an update on Australia? Is it still $60 million of revenue this year, ramping next year and the year after? Maybe just give us some perspective on big campaigns that are underway by region or by country.

William M. Brown - *Harris Corporation - Chairman, President & CEO*

In the -- I mean, I'll start on that, and maybe Rahul can jump in. So the International Tactical pipeline is around $2.3 billion and again, it's about where it's been over the last number of quarters. And I think it's good news that despite the orders, it's holding relatively stable. The -- about 55% of that is in Middle East and Africa, and that's a little higher than it was last quarter, so we continue to see opportunities flowing into the pipeline in the Middle East, as we've talked about Iraq in the past. Iraq is a very big, important opportunity, it's well funded. There's lots of opportunities for us to grow in Iraq. We see opportunities in Kuwait, some opportunities evolving in the Saudi Arabia, in the UAE, especially as we continue to execute well on the Emirati Land Tactical system, the network system that we're installing there, which is going to be going through an IOC very, very soon, hitting a key milestone. So we see good opportunities continuing in the Middle East. Europe is about 20%, more or less, of the pipeline. Again, we've -- we continue to see opportunities in the Ukraine. That looks fairly, fairly good as well as other NATO countries. And we're starting to see more opportunities in Western Europe evolve in Europe as well. In Asia, that's about 10% of the pipeline. So Australia is a key part of what we're executing there. That $260 million systems opportunity is going well. It's about that revenue opportunity in fiscal '18. It'll grow in '19 and '20, as we continue to work and complete that program. It's going well so far with the front end but going well. But there is a lot of follow-on opportunities in Australia as we execute well on that particular program. So I'm very encouraged about what's happening in the Asia-Pacific region. And importantly, as we develop more and more credibility around installing network systems, which is a much bigger market for us, and I went through a couple of the examples of what we've done in the past and what we're working on today, including another opportunity in a Southeast Asian country that was just awarded to us in terms of a systems modernization that builds on a legacy installed base. So those are the big major opportunities. Central Latin America is about 10% of the pipeline. It depends on what we see happening in Colombia and Mexico. Last year was very a very good year for Mexico. This year is a bit softer. But we do expect to see -- continue to see recapitalizations there. And then Central Asia, which is Afghanistan, Pakistan, was a small piece of the pipeline, very small piece of our revenue this year. It could start to grow over time. I'm not looking at that being a growth market for us in fiscal '19. So maybe that's a little bit of color on the international side.

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

That's very helpful. And could you give us an update on the DoD tactical? Last time, I think, the pipeline was about $1.4 billion to $1.5 billion. Is it the same and...?

William M. Brown - *Harris Corporation - Chairman, President & CEO*

Yes, it's about the same, Gautam. It's about $1.5 billion, with just over $1 billion in, what we call base. So that would be readiness and resets. It's -- HF radios will be in the base, and there are some opportunities on HF. And then the balance would be modernization. So that's the HMS programs, SOCOM, some opportunities for the radio for the WIN-T system. That's a bit higher than it was -- where it was last quarter, as you'd expect. As we march off in time, more and more of the modernization opportunities will come into the pipeline. Certainly, as indicated in the budget as well. So again, about $1.5 billion for DoD and consistent with where we've been.

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

And Bill, you've done an admirable job since you've become CEO. Company's in a much better position, cycle is helping, et cetera. I'm just curious, your cash free deployment, historically, has been for share repurchase and debt repayment. When you think about the next 5 years, is M&A going to be a bigger part of the story? Or how do you think about where you want to take the portfolio over time?

William M. Brown - *Harris Corporation - Chairman, President & CEO*

Yes. Look, I think our portfolio is in really, really good shape, and you can see it through the solid execution over the last number of quarters. We've got very strong businesses, very stong franchises, good share. We invested very aggressively in IRAD over the last 5 years. Even in a difficult sequestered market, we invested in IRAD. And a lot of things that we're talking about today as great opportunities and how will position come from a lot of those strategic investments. We -- when the market was really soft, we executed on the Exelis transaction. We integrated very, very well. And I think it's positioned us -- helped us reshape the portfolio as well. So sitting here today, we're going to generate a lot of cash in the next couple of years, sort of north of $2 billion of cash in the next few years. Less than $1 billion of that will be for dividends and a little bit of debt next year. So it leaves a lot of capacity for either M&A or to buy back our stock, as we continue to see value in our stock, both this quarter as well as going into next year. We think there's value remains in the Harris' stock. So we're going to be thinking hard about this. We think that there is opportunity to continue to do M&A. It'll happen over time. I think that's going to be a key part of our long-term strategy. But that's -- but I don't see us diverting from the core business franchise that we're in today, Gautam. I see us continue to bolster the business that we're in today, which, again, are performing exceptionally well.

Operator

Our next question comes from Carter Copeland with Melius Research.

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

Bill, I wondered if you could expand a little bit on the commentary around the expansion and the opportunity pipeline and the adjacencies you highlighted. Just maybe some insight into the color on that expansion and what opportunities it might have, both on the R&D front or the M&A front or the CapEx front to go capture some of that? Just an understanding of what the next leg might be in terms of how you expand what you've already done.

William M. Brown - *Harris Corporation - Chairman, President & CEO*

Yes, I mean, as I see there's adjacency opportunities really across the businesses and I spoke a little bit about it in the tactical side as we moved from a large player with high share in the ground tactical network, ground side to continue to grow, leveraging the platform investments we made for DoD and selling them into the international market. That's been a proven strategy, it's worked very, very well and that's why we've got a very high share even at the international markets we play in, where they're not restricted markets. And we laid out a very clear strategy to investors of taking that solid base and opening up the addressable markets. So going more into network systems. So where we have the radio, packaging systems around that to make it easier to use and more intelligent for the end users like Australia, like we've done in the UAE and other places as well as get a systems opportunity in markets where maybe we don't have the incumbent radio position and use that as a way to go in and pull the radio that maybe with another competitor into Harris. So that's been a clear direction that we've been on as well as take our great position on ground radios into the airborne side and clearly, the ARC-201 product from the Exelis allows us to go into that particular market as well as airborne ISR. And again, this is a very important win that we just received in the last week, this $130 million IDIQ, I think, is testament to the capabilities that we have across these different domains. And Carter, these are areas that we've been investing in IRAD in over the last couple of years. So I don't see a big step-up from here to go and penetrate these domains. I see it as a continuation of the investments we have been making. The other thing we've talked quite a bit about is some of the adjacencies that we're attacking in the intelligence community. We've talked about moving for over time from being a component supplier to supplying subsystems to now supplying complete end-to-end mission solutions, like we've done on smallsat. That has been a significant investment on our part. The -- our IRAD investment in our Space and Intelligence business has crept up over time. And it really is going after those kinds of opportunities. Winning this $0.5 billion exquisite system that we just won in the last couple of weeks, which is -- which really shows the power of the model we have in our Space and Intelligence business to both go after new end-to-end mission solutions as a prime but also be the partner of choice for components and subsystems for large exquisite systems. So I think this balance is working very, very well for us. And as I see, going forward, I see our IRAD in the same range we're in today as a percentage of revenue could tick up a little bit but not materially.

Operator

Our next question comes from Pete Skibitski with Drexel Hamilton.

Peter John Skibitski - *Drexel Hamilton, LLC, Research Division - Senior Equity Research Analyst*

Bill, let me start with the F-35, just we seem to be reading more and more about cost pressures on suppliers for the F-35 big. Just wondering if that's impacting you guys at all yet? And/or do you still see an opportunity to expand your content there?

William M. Brown - *Harris Corporation - Chairman, President & CEO*

Well, both actually. I think -- we are a pretty significant player on the F-35. I think we're in the top 15. We have about $2.2 million worth of content per ship set on F-35. And that -- we see that growing, perhaps, over time with some of the recent wins and a few things that we were working on the open-mission system computer. So we do see cost pressure, and I think we've been performing exceptionally well. Our job really is to continue to add capability and continue to take cost out. And when you look at the performance of the company, we're more than 99.5% on time for over 1 million components that we deliver to date on F-35, so we're a very good supplier there. We've reduced cost by more than 2/3 from the first ship set on F-35. So I think we've demonstrated capability and willingness to work hard to take -- continue to take cost out as the customer and our partners are moving to block buys, it'll help us continue to take cost out and as we move to open systems, there's lots of opportunities to both gain share and drive a more affordable aircraft, a Lockheed, to [Indian] customer. So it's always embedded in our numbers and it's all part of what we've been doing for the last decade or more as we've worked on F-35.

Peter John Skibitski - *Drexel Hamilton, LLC, Research Division - Senior Equity Research Analyst*

Okay, that's great. And just last one for me. On Army radios, I think this would be characterized under radios maybe, but a couple of programs I think in terms of demand for you won the sole creation of the Army security forces assistance brigades. And then the other one, I had a question was on MUOS backfit. And my question for both of those is really, how much of, kind of, incremental demand have those 2 programs have driven for you? How much longer will they last? I'm just wondering, kind of, on the time line, how far along we are on those 2 opportunities.

William M. Brown - *Harris Corporation - Chairman, President & CEO*

Yes, Pete. Both -- our readiness demand is both Army and Air Force this year, and it's about $100 million, maybe just a tad above $100 million. Roughly, half of that is the Army, and it's outfitting 2 SFABs. There's 2 security forces assistance brigades in our fiscal '18. Not all of the content was Harris'. There was content from other players. But as was about half of that $100 million, $105 million. As we go into next year, I think the idea is to outfit another 4 SFABs in the Army, and then they'll decide exactly when that will be, the mix of radio product. It's going to be legacy, it's going to be new product. And all of that's being worked. But it looks like it'll be an opportunity for us in '19 or '20, based on what we're hearing from the Army in terms of outfitting additional SFABs.

Peter John Skibitski - *Drexel Hamilton, LLC, Research Division - Senior Equity Research Analyst*

Great, and then the MUOS backfit, are we done with the MUOS backfit, or more to go on that?

William M. Brown - *Harris Corporation - Chairman, President & CEO*

Yes, MUOS is going very well. In fact, we, as you know, we have a MUOS capability in our 117G. We've been selling that capability and software upgrades to the Marine Corps, to SOCOM, to the Air Force. It is a threshold requirement for the Army new radio. So one of the reasons why we've had to deliver 100 test radios to the Army for this field-based risk reduction that's occurring imminently, really, is to validate not just other things but including MUOS capability in the new generation of Army radios. And again, we'll have -- we'll clearly be able to achieve that and develop success on that this summer that allows that fielding happen into next year. So for us, MUOS has been a good story both on driving it back into legacy radios but also embedding into the new ones.

Operator

Our final question come from the line of Robert Stallard was Vertical Research Partners.

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

Just a couple of technical follow-up questions for me. First of all, your thoughts on the capital structure going forward? What's your latest on what we can expect in terms of debt repayment or refinancing over the next couple of years?

William M. Brown - *Harris Corporation - Chairman, President & CEO*

Let me start with this. We paid $550 million of debt in the month of April, so that's it for fiscal '18. We borrowed $300 million in a floating rate note to fund the pension that is due in the year. We'll pay that in '19. Beyond that, we don't see any further debt repayment. Any debt that's due will likely be refinanced. We'll hit down to low 2s to 2 to 3x delevered by the end of this year and then even lower next year. We feel very confident and comfortable with where our debt structure happens to be in our credit ratings.

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

Okay. And then secondly, on the tax. There has also been a lot of stuff moving around this year. But what would you expect to be, sort of, steady run rate going forward in '19 and beyond?

Rahul Ghai - *Harris Corporation - Senior VP & CFO*

So right now, Rob, what we're thinking is around 18% for next year. Again, part of that coming from the step-down in getting half the year of tax reform and some of the other tax planning work that we've been doing. And I think that 18% is kind of sustainable going forward. So we see another step-down from 22.5% this year to 18%, and that, we feel, is kind of sustainable rate going forward.

Anurag Maheshwari - *Harris Corporation - MD of Asia-Pacific*

Thank you, everyone, for joining the call this morning, and please do not hesitate to get in touch with me if any additional questions. Have a great day, everyone. Thanks.

Operator

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