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LHX.N - Q3 2020 L3harris Technologies Inc Earnings Call

EVENT DATE/TIME: OCTOBER 30, 2020 / 12:00PM GMT

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## PRESENTATION

**Operator**

Greetings. Welcome to the L3Harris Technologies Third Quarter Calendar Year 2020 Earnings Call. (Operator Instructions) As a reminder, this conference call is being recorded.

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

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

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

First, a few words on forward-looking statements and non-GAAP measures. Forward-looking statements involve risks, assumptions and uncertainties that could cause actual results to differ materially. For more information, please see our press release, presentation and SEC filings.

A reconciliation of non-GAAP financial measures to comparable GAAP measures is included in the Investor Relations section of our webcast, which is l3harris.com, where a replay of this will also be available. And to aid with year-over-year comparability following the L3-Harris merger, the first half of prior year results will be on a pro forma basis.

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

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

Thank you, Rajeev, and good morning, everyone. So 2 years ago this month, we announced the merger of L3 and Harris. And thanks to the hard work and perseverance of our employees, we've been able to deliver results consistent with or better than expectations despite market volatility and unforeseen obstacles like COVID. Their efforts have led to another strong quarter and put us in a position to raise our 2020 guidance.

The mitigation plans we implemented earlier in the year to manage COVID-19 have proven effective in keeping our employees safe and our facilities open and will remain in place for the foreseeable future. We also continue to support our supply chain through accelerated payments, totaling over $200 million in the quarter and nearly $0.5 billion year-to-date, and we expect these advances will continue in the fourth quarter.

Earlier today, we reported third quarter results with non-GAAP earnings per share of $2.84, up a solid 10%. Company margins expanded 60 basis points to 17.9% on organic revenue growth of 4.5%, and adjusted free cash flow was $726 million. Our core U.S. and international government businesses were up over 7%, including double-digit growth internationally, partially offset by COVID-related impacts on our commercial businesses that were down largely in line with expectations.

With another quarter of strong execution on our -- under our belt, we're improving our outlook for the year and increasing margins, earnings per share and free cash flow to the upper end of the prior range while narrowing organic revenue growth to the prior midpoint of approximately 4%.

It's worth noting that despite the pandemic headwinds, we're back to the midpoint of our initial 2020 earnings per share guide, a testament to the benefits of the merger and our earnings power.

Integration activity continued to progress well. And then in the quarter, we delivered net cost synergies of $50 million, bringing year-to-date savings to $165 million and well on track to meet our $185 million target this year. At this rate, we'll exit the year with $250 million in net cumulative savings, which positions us to deliver at least $300 million net in '21, a year ahead of schedule.

Our E3 operational excellence program continues to mature and become institutionalized and, alongside cost synergies, was a key driver of the 60 basis points of margin expansion in the quarter and 130 basis points year-to-date. With our strong performance to date, we're increasing our margin guidance to approximately 17.75% for the year, a 100 basis point improvement from 2019 and a solid base to build on over the medium term.

As we look beyond 2020, we see 3 primary building blocks supporting mid-single-digit top line growth. First, we have a portfolio that is well aligned with national security priorities, irrespective of the outcome of the elections. Our broad C5ISR capabilities are essential elements encountering the near-peer threats identified in the National Defense Strategy: resilient communications, open architecture command and control, offensive and defensive cyber and ISR across all spectrums, electro optical, infrared, hyperspectral, RF, sonar; and all forms of intelligence, signals, comms, electronic and image.

We have leadership positions in many of these areas and operate in all domains. And we've realigned our R&D efforts to extend our position through investments in open architecture, multifunction, software-defined technologies. The security threats are real, and we anticipate that future defense budgets will continue to prioritize spending in these areas where we're well positioned and we're investing.

Second, we uniquely benefit from the revenue synergy opportunities created in a merger of 2 complementary companies that expanded our addressable market. This quarter, we received an additional 12 revenue synergy awards, bringing the total down selected proposals to 25 out of 37 for a cumulative value of over $300 million, an initial down payment on our multi-billion dollar pipeline.

Two recent wins worth highlighting are the Space Development Agency's tracking layer, which leveraged legacy Harris' strength in space payloads and integration with L3's onboard space avionics solutions. The other is SAFE-SiM, a DARPA program to simulate and train for future multi-domain battle that addresses the challenge of secured data sharing of highly classified sensors.

And third, we see upside in international, which, at about 20% of revenue, is underrepresented versus peers. With a now larger international footprint, we can better leverage our scale and extensive sales channels and capitalize on our domestic position to support global modernization efforts and extend our ISR leadership in the airborne, land and maritime domains. And as seen with recent awards this quarter to deliver missionized aircraft to both Canada and the Royal Australian Air Force, we're making progress.

Our top line and margin opportunities, along with our discipline around working capital and CapEx, support our free cash flow potential as well as our ability to return capital to shareholders. We're off to a good start to date and now expect to deliver free cash flow of approximately $2.65 billion to $2.7 billion for the year, at the top end of our prior guidance.

This performance, coupled with divestiture proceeds, has enabled us to return over $1.3 billion of capital to shareholders in the third quarter, which put share repurchases to date at $1.85 billion, ahead of our full year 2020 commitment of $1.7 billion. For the full year, we now expect share repurchases to be about $2.2 billion, a pace we plan to sustain through next year.

On portfolio reshaping, we're about 1/3 of the way through our bottoms-up target of divesting 8% to 10% of revenues, and activity continues to be robust. Our criteria and strategy haven't changed as a result of recent events. We continue to be patient and persistent as we look to maximize value. And as previously stated, we will announce divestitures as they occur with proceeds primarily used for capital returns.

So overall, we're executing well despite the uncertain times. And with our unique revenue, margin and cash opportunities, we remain focused on delivering double-digit earnings and free cash flow per share.

So with that, I'll turn it over to Chris to discuss segment results. Chris?

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

Okay. Thank you, Bill, and good morning, everyone.

Let's go to Slide 5. Integrated Mission Systems revenue increased 6.2%, primarily from growth in our Maritime business, as recently awarded manned and classified programs began to ramp up, along with growth from our ISR business, driven by strength in aircraft missionization. The modest decline in our Electro Optical business was due to timing of deliveries.

Operating income was up 21%, and margins expanded 190 basis points to 15.5% from operational excellence and integration benefits, partially offset by higher R&D investments. Order momentum at IMS was broad-based with particular strength in Maritime, resulting in a segment funded book-to-bill of 1.08 for the quarter and 1.22 year-to-date.

Our Maritime business continued to build out its pipeline of opportunities following the Medium Unmanned Surface Vehicle award. Additionally, the team finalized its position on the largest -- as the largest subcontractor on the U.S. Navy's frigate program. We're playing a key role as a mission solutions provider for electrical propulsion and navigation systems. The current 10-ship contract could exceed $300 million if all options are exercised.

In addition, the Department of Defense recently reported its long-range plan to significantly expand the U.S. Navy's manned and unmanned ship count to over 500, with the greatest increase planned for unmanned vessels. With our experience and capabilities in both platform types, we are well positioned to support the Navy's growth.

Turning to Space and Airborne Systems, organic revenue increased 6.8%. Growth in our Avionics business was driven by the production and modernization ramp on the F-35 and increased classified work at Intel and Cyber. These were somewhat offset by program timing in the Space and Electronic Warfare businesses, which, based on recent awards, including the F-18 IDECM contract, position us for growth in the coming quarters.

Segment operating income was flat, and margins contracted 110 basis points to 18.5% as integration benefits and operational excellence were more than offset by program mix from recent wins. Overall funded book-to-bill was 1.04 for the quarter and 1.05 year-to-date with key awards received in our Space, Avionics and Electronic Warfare businesses.

As Bill highlighted, our Space business was 1 of 2 awardees for a contract with the Space Development Agency to develop and integrate an end-to-end system of 4 satellites, where we are providing both the bus and mission payload, validating our space strategy to become a mission solutions prime. This system will provide warning and tracking of advanced threats, including hypersonic missiles.

The initial satellites will be launched within the next 24 months and support the tracking layer of the DoD's missile defense network in space. Once fully operational, there could be a demand for many more satellites with the value well into the billions, leading to the next space-based franchise for our company. We expect to build on these opportunities in the near to medium term with a space pipeline of over $10 billion in opportunities.

Next, Communication Systems organic revenue was up 6.7% for the quarter, driven by Tactical growth in the mid-teens, which included international growth of about 20%. The Middle East, Europe and Asia Pacific provided most of that growth. Both DoD Tactical and Integrated Vision Systems benefited from continued modernization demand. This strength was partially offset by our Public Safety business due to COVID-19, which was down, consistent with expectations, in the mid-teens.

Segment operating income was up 17%, and margins expanded 230 basis points to 25% from operational excellence, integration benefits and cost management. Funded book-to-bill was about 1.0 for the quarter and 0.94 year-to-date and was particularly strong in Tactical Communications at over 1.1 for the quarter. This was driven by an initial full-rate production award on the U.S. SOCOM's multichannel manpack program as part of the $255 million sole-sourced IDIQ, an important milestone for this multiyear modernization strategy. We also saw healthy activity on the international front, including customers in the Middle East, where we continue to build out our installed base and identify new opportunities.

Lastly, Aviation Systems organic revenue decreased 4.1% as the anticipated COVID-19-related impacts in commercial aviation were partially offset by consistent strong performance in Defense Aviation Products, which was up high teens; and Mission Networks, which was up mid-single digits. Operating income was down 19% with most of the decline resulting from divestitures, while margins contracted 40 basis points to 13% as integration benefits, operational efficiencies and cost management were more than offset by COVID-19-related market headwinds in commercial aviation.

Third quarter funded book-to-bill was 0.94, following strong first half orders, resulting in a year-to-date funded book-to-bill of 1.08. Award activity was notable on several ground vehicle programs from the DoD and international customers for our power and propulsion systems, which totaled approximately $150 million. In addition, we recently announced that we're a partner with Northrop on the U.S. Air Force's GBSD program for operations and maintenance training systems, highlighting continued progress with next-generation programs and platforms.

Now over to Jay, who will discuss the financials in more detail as well as our guidance.

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

Thank you, Chris, and good morning, everyone. I'll begin with a quick recap of third quarter results and then shift over to our updated outlook.

In the quarter, organic revenue was up 4.4%, and margins expanded 60 basis points to 17.9% as the benefit from synergies more than offset higher R&D investment. Earnings per share grew 10% or $0.26, as shown on Slide 9. Of this growth, synergies and operations contributed $0.24, along with a lower share count for $0.13, which more than offset headwinds from divestitures and pandemic-impacted end markets.

Free cash flow for the quarter was $726 million, and we ended the quarter with 55 working capital days, holding the strong first half improvement of 7 days. With year-to-date organic revenue growth just over 4% and margins of 17.9%, along with a 5% higher backlog, L3Harris is set up well to close the year.

So let's turn to Slide 10 to cover our updated outlook. Organic revenue is now anticipated to be approximately up 4% or at the midpoint of our prior range, with the top line trending largely as expected. Our core U.S. government businesses continue to perform well, up about 7% year-to-date and driven by DoD tactical radios, maritime, mission avionics and classified growth at intel and cyber and defense aviation products.

On the international side, the business returned to growth in the third quarter, up double digits, which sets up for a flattish year or better, supported by ISR and international tactical radios. And finally, this guidance reflects about a 2-point impact from our commercial businesses due to the pandemic, in the range of our initial assessment.

Shifting to margins, we've revised our outlook to approximately 17.75%, a 25 basis point increase versus our prior expectation from better cost performance and mitigation of COVID impacts.

On EPS, we are raising our full year to approximately $11.55, at the top end of our previous range and consistent with the midpoint set at the beginning of the year. As shown on Slide 11, the increase of $0.20 from the prior midpoint is primarily driven by $0.13 of improvement in operations, including our mitigation efforts, plus $0.07 between a lower share count and other items.

Moving to free cash flow, we now plan to deliver approximately $2.65 billion to $2.7 billion or the upper end of our prior guidance, driven by higher net income and CapEx discipline. This keeps us on track to deliver our 2022 free cash flow target of $3 billion and double-digit annual growth on a per-share basis.

On capital returns, we returned over $1.3 billion to shareholders in the third quarter with $1.15 billion of share repurchases and 175 -- $179 million in dividends. Year-to-date, total buybacks were $1.85 billion, ahead of our prior target of $1.7 billion for the year. With an elevated cash position and solid cash generation anticipated in the fourth quarter, we now expect share buybacks for the year to be around $2.2 billion. And we expect to continue our shareholder-friendly capital framework into 2021 as we normalize our cash balance, generate healthy cash flow and continue shaping our portfolio.

Now switching to our segment outlook. In Integrated Mission Systems, we now anticipate revenues up approximately 6% for the year from the prior range of up 5.5% to 7%, driven by growth in ISR and Maritime. Segment margin is now expected to be about 15%, up 150 basis points versus the prior guidance, driven by solid program performance and cost management.

At Space and Airborne Systems, we're now guiding to organic revenue growth of approximately 7%, within the previous range of up 6% to 7.5%, as higher F-35 revenues continue to drive Mission Avionics. Segment margin guidance remains unchanged at approximately 18.75%.

In Communication Systems, organic revenue growth is expected to be approximately 4% and within the prior range of up 3.5% to 5%, mainly driven by modernization strength in DoD tactical radios. Segment margins are now expected to be about 24%, a 25 basis point increase from our prior guidance, primarily from mix related to our Tactical business and cost management.

And lastly, in Aviation Systems, we now anticipate revenues to be down approximately 3% on an organic basis versus our prior range of down 1% to 5%, consistent with our prior estimates in the commercial aero business, partially offset by double-digit growth on the defense side from classified and other programs. Segment margin guidance remains unchanged at 13.25%, reflecting the timely and decisive actions to mitigate commercial aero headwinds.

So overall, we delivered solid performance in the quarter and year-to-date and now expect to deliver results consistent with our original EPS and free cash flow guidance set back in February.

Before wrapping up, I'd like to briefly touch on our outlook post 2020. We'll provide 2021 guidance as we typically do with fourth quarter results. Though note, we remain confident in our framework of annual double-digit growth in earnings and free cash flow per share, as the building blocks remain the same: mid-single-digit top line growth, steady to rising margins, working capital and CapEx discipline and returning our free cash flow to shareholders through buybacks and dividends.

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

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## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions) And our first question is from Mike Walton (sic) [Myles Walton] with UBS.

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

You increased the repurchase effort by $0.5 billion, directionally closer to sort of your pre-COVID capital return level of $3.5 billion, but not quite there yet. I'm just curious, is there anything that would hold you back from going that much higher?

And then more philosophically, Bill or Chris, as you look at capital returns through dividends and repurchase, do you have more headroom here to maybe push the dividends a little bit harder? And do you think that would be more appealing to investors?

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

So Myles, I'll start on the second one, and maybe I'll ask Jay to come back on the first one on the buyback. Look, on capital returns, we -- the philosophy really is 100% of our free cash flow coming back to owners in repurchases or dividends, and we see that through next year. We've been leaning pretty heavily into share buybacks, and Jay will talk in a minute about our philosophy there. Based on our share price, we think that that's a good value.

We do see our dividend with some room to move up. We've been up about 25% in our dividend rate since close. We had raised it twice, once at close and once at the beginning of this year. But at about 28% of our free cash flow being paid out, it's below the bottom end of our range. And we'll expect to take a hard look at that early next year and probably lean a little bit heavier into our dividend. But broadly, all of our cash will come back to owners plus divestiture proceeds through at least next year.

Jay, you want to talk about the buyback?

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

Sure. Myles, in the third quarter, we increased a little bit relative to the proceeds, about $150 million. If you just do the math, I would say, $350 million here in Q4. You can back into our free cash flow for the fourth quarter. And with the dividends, we're approaching kind of the framework that Bill just mentioned as far as returning free cash flow to shareholders.

Yes, there could be a little bit more room there. I mean our balance is elevated with $1.3 billion at the end of September. Given where we are with the guidance we just gave you, we would expect the balance to continue to remain elevated in December. And so there could be opportunity there. We're also evaluating other items, which could include some pension contributions, but -- so we're leaving our optionality open a little bit. But if it doesn't happen in this quarter, then it would carry over into next year.

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**Operator**

Our next question is from the line of Sheila Kahyaoglu with Jefferies.

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

I wanted to ask about just integration activity. Clearly, it's been performing really well, and EBIT was up $32 million in the quarter. But ex synergies, your incrementals were about flat. And then the implied incremental for 2021, ex synergies, is 20%. So how are you thinking about maybe incrementals going forward outside of synergies? And what changes with mix going forward?

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

So Sheila, it's a great question. If you think about it, maybe in kind of a little bit bigger picture, we end the year this year, we'll be at 17.75% for the year, around that ballpark. We do have incremental synergies next year, $50 million. That equates to anywhere around 25, 30 basis points of expansion. Our core E3 productivity is obviously going to be a driver for us, but we do have some mixed headwinds that we'll be dealing with, and we deal with that every year.

And so our intent always is to drive more than the mix headwinds. But I think for now, right now, as we're continuing to go through the planning, offsetting one for one is where we stand at the moment. The only thing I'll say is that we will see a little bit of a headwind in Q1 because of the -- just the roll-through of the commercial, the pandemic-related impacts roll through the 4 quarters. And so that will put a little bit of pressure on Q1, which will also have an impact, obviously, on the full year.

But having said that, I think mix is something we just have to keep an eye on, but our core E3 productivity is intended to offset that on a kind of run rate basis and drive. Once we get beyond the synergy period in the integration period, our core E3 operating excellence program will continue to be a driver of margins for us.

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**Operator**

Our next question is from the line of Kristine Liwag with Morgan Stanley.

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**Kristine Tan Liwag** - *Morgan Stanley, Research Division - Equity Analyst*

Bill and Chris, what drove your narrower 2020 revenue outlook? And I know it's still too early to talk 2021, but how much of your expected 2021 revenue is already in the backlog versus what you need to go out and win?

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

So right now, as you'll see in the Q, our funded and unfunded backlog at the end of Q3 was about $20 billion. And you'll note there about 2/3 of it, 65%, rolls out through calendar '21. So we think that, that part of our business is pretty solid. We've got a very good pipeline, $69 billion. It's come up over the last quarter. It's come up about 8% or 10% since the beginning of the year. So it continues to grow, be very robust.

And as we look into next year, and to Jay's points about mid-single-digit growth, we see good solid growth in our core U.S. government businesses. You've heard a couple of our peers talk about low- to mid-single-digit growth there. We will add on top of that with revenue synergies that we've talked quite a bit about. We see international growing. It's a growth business for us here in the back half. Book-to-bill was very good. The pipeline is really strong internationally. We see that being a contributor into next year. And certainly, as Jay just mentioned about commercial, it will be a little bit of a headwind until we lap 1 year on COVID. But the other dimensions will be pretty strong going to next year.







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**Operator**

Our next question is from the line of Seth Seifman with JPMorgan.

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

Maybe 2 areas following up there to talk about growth. One is in space. I know, Chris, you mentioned a lot of the opportunities there. Is there a point in which we should see the -- maybe the book-to-bill step up even further and the backlog start to grow a little bit more? And then, Bill, you just mentioned the international opportunities. Are those principally on the tactical radio side? Or are they across IMS or avionics or other areas?

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

Seth, I'll take a first shot at both of those. Yes, so in space, we're going to be seeing the book-to-bill increase. We talked about some of the key wins we had here in the third quarter. We talked about our strategy to be a mission solutions prime, and it's really taken traction here. The SDA win was a big one. There are some opportunities coming down the pipe in the fourth quarter. A fair amount of them are in the classified world, but you'll be able to see that in the quarters ahead.

As Bill said, on the international side, we do have a strong pipeline, a good book-to-bill. The tactical radios are going to grow. That represents about 20% to 25% of our international revenue. We're really seeing it across the board. The ISR platforms are doing well with the aircraft missionization and, of course, the Maritime business. So it's pretty well spread out across the portfolio and the domains.

**Operator**

Our next question comes from the line of Gautam Khanna with Cowen.

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

Congrats on the SDA win. Guys, I was hoping you could elaborate on the revenue synergy opportunity. The SDA win seems like that was -- that kind of establishes a new franchise for you guys. Are there other kind of new franchise-setting opportunities within that pipeline that you could maybe elaborate on so we could think about growth beyond '21 as well? And would you be willing to opine on where you think the top line will shake out in terms of growth rate in '22?

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

Well, first, on '22, it's a little bit further out in the future, but I might -- maybe answer the first part of the question, as Chris thinks about if he wants to give any guidance on '22. But we're making really good progress on the revenue synergies. And I think this has been a pleasant surprise to all of us in terms of the pace and magnitude of getting that revenue opportunity. I think it points to the strategic rationale of the combination and the complementary nature of the technology that we're working on. So again, we're about 80 proposals that have been submitted. It's come up from Q3. We're winning quite a few of them. 25 out of 37 is pretty healthy with $300 million of awards.

We talked about a couple of these are some of the -- certainly, the SDA win is one of the bigger ones. But generally speaking, they're going to be in the space domain, electronic warfare, some in maritime. And there's quite a lot that's happening in the classified domain. As we said over multiple calls, one of the things that was unique here is, as we put our companies together, we got a lot of input and feedback from our classified customers who really see across our portfolio and across other missions across other companies and really giving us strong guidance as to where there might be opportunities to combine capabilities within L3Harris. And the team has worked very hard to put together some compelling proposals, and we continue to win.

So it's modest growth this year. It will start to grow next year and be a good contributor in '21 and certainly more beyond that. It will grow to hundreds of millions over the next year or 2, which I think is a very positive sign for not just winning them, but actually seeing them come through in revenue opportunity. So I'm really, really pleased here, Gautam, on sort of the revenue synergy.

I don't know, Chris, maybe answer the question on '22, if you want to take a stab at that one.

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

Absolutely. No, I agree with Bill, we're really outperforming here on the revenue synergy. And over time and probably by 2022, the business development pursuits and as the business integrates, these things are really going to be merging and part of our overall strategy. So I'm thinking by the time we get to '22, '23, I'm not sure we're going to be calling these out. What it is going to do is give us higher confidence in our growth rate that we've already talked about. So I'm looking for good opportunities and year-over-year growth improvement relative to revenue synergies. But over time, it's just going to be merged and part of our normal processes.

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

And I think Jay's comment about the mid-single-digit framework kind of expand -- spans a bit more than 1 year. Thank you, Gautam.

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**Operator**

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

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

Bill, I get this question a lot from investors, so I thought I'd give it to you. There's this perception that your portfolio is shorter cycle than your peer group. I guess, how much of your portfolio do you view as short cycle, converting from backlog into sales, I guess, within 12 to 18 months? And do you view your portfolio as shorter cycle and, I guess, more at risk than your peer group to lower budgets?

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

So David, thanks for the question. Look, as I mentioned earlier, about 2/3 of our backlog coming out of Q3, what you'll see in the Q is around 20 -- a little over $20 billion, funded and unfunded, rolls out over the next year. And what I've seen over time is it's hard to compare our portfolio sort of short, long cycle versus peers. But certainly, it has lengthened over the last several years as some of the programs that we worked on, specifically in tactical radios, have moved from sort of book and ship, a quick turn to replenish spares or radios in Iraq and Afghanistan, to now being fundamental long-term programs of record, which a lot more -- longer visibility in terms of the buying pattern, the spending outlook.

So we certainly see our portfolio being longer term than we were several years ago. And certainly, combining with L3, I think, puts us in that position as well. So again, I think our portfolio is very sound. It's robust. We're well positioned to grow into next year.

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**Operator**

Our next question is from the line of Pete Skibitski with Alembic Global.

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

Bill, can you maybe talk at a high level about these new concepts as ABMS and JADC2? I think you have some bids in there, and they seem pretty well supported in DoD. I just wondered if you can maybe size the opportunity set for you there. It's still a little nebulous. And maybe talk about timing, just maybe level set us on your expectations.

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

So Pete, it's a very good question. Look, you know what -- and I took some pains in my comments to talk about the broad set of C5ISR capability we've had across the company. And when you break down C5 and ISR into its components and domains, different sensing technologies, we've got a very strong position across all of them, all of which are essential in enabling this JADC2 or Joint All-Domain Command and Control vision of the future. We're a strong player there. I think on ABMS, we've -- lots of players on the IDIQ, but we are across all 7 business areas, which is somewhat unique. We had content on Project Convergence, which is sort of the Army version of that, in partnership with the Air Force. We had a lot of content there, and we'll hope to see more as it gets into the next version of it next year. We're very strong in maritime and distributed maritime operations.

So we believe this is a strength of ours. We've got very strong capabilities in comms, resilient communications, which is developing very strong, resilient wave forms. L3 was -- had a strength there. We had certainly a strength there, very strong ISR. So to me, we're right in the middle of this. And I think it's fundamental that JADC2 or that vision, that concept is going to be required in a near-peer competition. It's going to be more about the capabilities on platforms and how they inter-operate as opposed to the platforms themselves.

And when I think about this powerhouse that we've created here at L3Harris, Pete, I think we're right going to be in the middle of it. It will grow over time. There's funding there, and we're confident that's going to be a driver for the company over time. It's hard to size it today, but we believe it's going to be pretty important, Pete.

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**Operator**

The next question is from the line of Richard Safran with Seaport Global.

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**Richard Tobie Safran** - *Seaport Global Securities LLC, Research Division - Research Analyst*

Just a very quick question here on R&D. I wanted to ask you about your opening remarks on research and development. Given the number of wins and the fact that your win rate has been increasing in your remarks, I want to know how you're thinking about R&D longer term, if you think it could be ratcheted back a bit? Do you need to spend more R&D to support the increasing win rate on programs? Or are you really just about the right level right now?

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

Hey, Richard, thanks for the question. I think you're hitting on a very important topic, and that is the power of the IRAD that we spend and the work that's happened over the last 5 quarters. We're spending in the 3.6%, 3.8% of our revenue, in that range. We think it's sized well. And I think, more importantly, what the team has done is worked very hard over the last 5 quarters to make sure it's spent on the best, highest-value, highest-return opportunities and focusing that spear we call IRAD. We've reduced the number of projects by about 30%. We moved about 10% of the dollars around to really be placed on the technology, the areas that we think will have the best returns or aligned to revenue opportunities, revenue synergies.

And the second element of it is making -- not just putting the -- making sure we're spending on the right projects, but also doing it efficiently. So we've got good opportunities to drive operational excellence skills into the way we develop products. We're pushing hard on digital engineering, on DevOps, and a lot of our work is software development. There's lots of ways to improve the effectiveness of our R&D spend. And to me, this is going to be a very powerful driver of growth in the future. I don't see it stepping up materially from where we're at. I think it's at a good amount. It will come up with revenue in the terms of a dollar perspective, but I think we're spending a healthy amount on R&D.

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**Operator**

Our next question is from the line of Doug Harned with Bernstein.

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

I want to go back really to the budget here. When you look across the portfolio, I'm trying to understand how your businesses are affected by end strength and forward-deployed end strength. And changes really aren't in the plans right now. It's in terms of at least basic number of, let's say, army troops. But we're about to have an election. So if we were to see military personnel reduced in the coming years, how would that affect you?

And I'd ask the same thing for changes in forward-deployed troops such as movement in troops out of Afghanistan, Iraq or elsewhere. So when you look across the businesses, how are you tied to those levels?

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

So Doug, I'll start here, maybe going to ask Chris to jump in. I don't think we're going to be much affected by redeployment of overseas troops back onshore. I don't think that's going to be a big driver of growth, either a top headwind or a tailwind.

On end strength, it would come back to things like businesses like night vision goggle or radios, where those are distributed out to individual soldiers. But frankly, we're on the front end of a modernization ramp even through the next 5 years. We're not even 40% through the modernization ramp in -- with radio. So even if end strength comes down, as I expect it likely will, I don't think it's going to affect the growth rate in our radio business. I think you are so far underpenetrated with new technology, both night vision as well as radios, that we still see good growth opportunities there. So if anything, reduced end strength might actually free up some dollars to be put onto modernization investments that really affect a broad part of our business.

I don't know if, Chris, you wanted to add to that?

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

Yes. And if there is a reduction in the forward-deployed troops, I mean you look at the rest of the portfolio, Doug, and situational awareness is going to be critical. So you look at the ISR assets that we have both in space and air and the need, as Bill talked about, for the multi-domain comms. It strengthens the rest of the portfolio. So I look at it as kind of a net-net push or maybe a slight positive when you look across all 4 segments. And the same theory applies internationally. There's just a lot of need for communications and situational awareness. So our ISR capabilities both in space, air, land and maritime, are well positioned.

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**Operator**

Our next question is from the line of Noah Poponak with Goldman Sachs.

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

So kind of every quarter, since the merger, we sort of all get on these earnings calls and question you on the sustainability of your growth rate and ask about short cycle and the O&M exposure. And I think those are sensible questions, and you guys provide decent answers to those that have some conservatism but are mostly qualitative in nature. And after every one of those conversations, the stock just de-rates, moving sideways, while you're performing well and the numbers are going up.

And so I guess I wonder, how much are you all talking about that internally in terms of a different way to start from scratch and reframe this for investors? I mean you talk about the handful of franchises you have. The defense budget is broken down into a handful of franchises. Is there a way to sort of, while still giving detail, like super simplify this so that people can see on a legit 3- to 5-year basis you really can keep growing mid-single digits?

Because otherwise, it just feels like we're just sort of circling back to the same things every quarter. I don't know. I mean maybe there's no good answer to that, and you just have to keep performing and the stock eventually matches to the numbers. But I was pretty curious if you guys talk about that or think about that internally and if you could share any thoughts with us.

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

Well -- yes, go ahead.

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

Well, no, I think I'd comment some of the new awards that we talked about. Just -- I think it demonstrates and is illustrative of our positioning for the modernization trends that we're seeing going forward. And so while people may want to focus on O&M budgets and historical tactical radios, the new awards that we're winning are really positioning us well for the trends that we're seeing in terms of defense priority spending. And so I think you should, as Bill mentioned, think about our portfolio and our revenue potential more in that broader context. And that's what gives us confidence in our mid-single-digit growth over, and we're seeing this in our new awards right now.

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**Operator**

Our next question is from the line of Robert Stallard with Vertical Research Partners.

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

Bill, you've mentioned defense exports a couple of times this morning. And I think earlier this year, you were suggesting this area could be a bit slower, but that doesn't seem to have happened. So wondered if you could comment on what changed there. And also looking forward and maybe to follow on, on Noah's question, how big could defense exports be as a percentage of sales going forward?

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

So yes, as we talked earlier this year, right after, I think it was Q1, maybe Q2, as we looked at the international business, we saw it being more flattish for the year. We saw the first half being down a little bit, the back half growing and being about flat for the year. Q3 came in strong like we had expected it would, a little bit better than we had thought. So it could be up a little bit, so flat to up low single digits internationally, so a little better than we saw a couple of months ago.

International tactical has come in almost exactly as we had expected. You could see the numbers up 21% in the third quarter. We expect the fourth quarter up a similar amount. So we see good recovery in that business. A lot of it is Middle East, Europe, Asia Pacific, mostly Australia and New Zealand. So there's pretty good growth in tactical.

And we've got a nice pipeline of opportunities. I think the number is about $20 billion of international opportunities. The book-to-bill year-to-date is over 1, about 1.06 or so. We see the fourth quarter looking -- shaping up to be pretty sizable in terms of book-to-bill, looks pretty good. About $3 billion of those proposals that are out there of our pipeline is in proposal. So it's actually getting to be more nearer term.

So it's looking a little bit more encouraging than we thought just a couple of months ago. I think Chris and the team are putting a lot of focus on this. We have resources in place going after 10 focused countries, and we're starting to turn the corner. So we're at 20% roughly in terms of our revenue. We expect it's going to grow several points over the next number of years. I don't know, Chris, if you want to state a goal there, but it's going to come up from where we are because it's underrepresented in our portfolio today.

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

Yes. I think, ultimately, the next target would be closer to the 25% of revenue over the several years. And what I like about our company is the portfolio and the demand for our products. And when you export, there's always a focus on offensive versus defensive products, especially as administrations look at approving these exports. And when you look at our ISR capabilities, the maritime capabilities, the radio to comms, those are generally easier to export and approve, regardless of which administration is running the country. So I think that gives us a lot of confidence.

And we've been able to stay in touch with our customers. We have executives forward deployed full time in the focus countries. And all of us have been using new technology to call Zoom and stay in touch with our customers really on a weekly basis, and that's working well. We're negotiating contracts via Zoom and continuing to keep the business running. So very optimistic on international.

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**Operator**

Our next question is from the line of Peter Arment with Baird.

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

Bill, I guess on the working capital, you've given us a lot of details. Just kind of a clarification, is the 7-day improvement year-to-date the number? And is that a good kind of, I guess, pacing item as we think about your goal to get to the low 40s as we think about next year and into '22 to hit that kind of $3 billion free cash flow target?

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

Yes. Thanks, Peter. Yes, so 7 days year-to-date, it's about 13 days operationally since the close. So we put out our divestitures and purchase accounting. We will see towards the back end of the year. We'll probably stay right on 55 days. So you won't see 7-days improvement over 3 quarters as the continued pace into the future. We see the 55 dropping below 50 over the next couple of years, 3 to 4 days per year. That gets us to the $3 billion goal in calendar '22. We still see an opportunity to get down to the low 40s or about 40 days. Certainly, that's where legacy Harris was. We've seen our peers at that point. So even after calendar '22, 47, 48 days, we see opportunity to continue to prove working capital beyond that.

As I said last time, and we've talked about this a number of times, a lot of it is going to be on inventory. So we've got a lot of opportunity here. We know where it's at. We've got 10 businesses that we're really focused on that drive 75% of our working capital, 6 with more than 75 days. So we know where we're focused. We're driving it hard. We review these every single week. And you can see the progress and trajectory that we happen to be on. So again, about 3 to 4 days a year beyond calendar '20.

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**Operator**

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

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

I know you talked a lot about margin going above 18% with the synergy drop-through offsetting the mix. I think there's been some conversation over the last month or so about a long-term opportunity for 20% margin. What's your perspective on how you get there? Is it all in your control? Or do you need some customer behavior to change?

And then also, if we're going to get there, is it linear? Or could there something -- could something big pop up in a given year, such that you have to make a big investment, margin could step back for a year or 2 and then kind of hitting that margin expansion growth trajectory again? So more of a long-term question there around margin.

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

Hey, Jon, look, it's a good question. I mean I think we're really performing better than we had expected on margins even through this year. Keep in mind, we started the year, I think, guiding to 17% to 17.5%. And now today, it's 17.75%. So in an era of COVID, which actually dinged us about 40 basis points this year, so we're performing very, very well. It comes through the synergy drop-through. It comes through operational excellence, which is maturing at a fast clip.

Jay has talked about 18% or so next year. He gave you some of the drivers. Will it go up beyond that? It will likely move up. I don't know if and when it will hit 20%. I think the key thing to be thinking about is we got to make sure that we're leaning in to go after and drive revenue growth, capturing some opportunities, which might have a near-term, short-term impact on margins, but long term be good businesses for the overall enterprise.

We got to make sure we continue to invest at the level required to grow the business on a long-term basis. Anyone could easily pull back investment like IRAD and drive margin up in the near term, but be detrimental on long-term value for the owners. I think you have to work the pedals here, and I think we do this very, very effectively. So we can't commit to something beyond next year, but we will commit to continue to work the agenda to drive hard on technology investments, which drive differentiation, and good cost management, lean productivity across the whole company.

**Operator**

Our next question comes from the line of George Shapiro with Shapiro Research.

**George D. Shapiro** - *Shapiro Research - CEO and Managing Partner*

I wanted to know what's the progress payment benefits you've gotten this year and then how much benefit from payroll deferral. And is that inhibiting getting to the $3 billion of free cash flow next year? I'm assuming CapEx probably is no higher next year than what you're saying this year.

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

Sure, George. Thanks. The progress payment benefit this year is in the range of, say, around close to $100 million, in that ballpark, maybe a little bit lower than that. That one, we basically have offset with small supplier payments. And so it's just one for one as it's come in. We really pushed supplier payments out.

On the payroll tax benefit, that's kind of $150 million plus, in that ballpark, similar type of effort. We've kind of put a placeholder there to support supply chain there as well. That, as you know, will be paid back over 2 years, '21 and '22. But I would say, as it relates to kind of longer-term targets and our $3 billion target, there's a number of puts and takes. There's risks and opportunities. We've got that factored in. We feel good about our ability to generate continued working capital improvement, and we don't see that getting in the way of us getting to $3 billion in '22.

**Operator**

Our next question is from the line of Ron Epstein with Bank of America.

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

Bill, just following up on one of your earlier comments. You gave us some color on the growth in classified. Can you give us more detail on that? And you mentioned that that's a big area for synergies. I mean -- and then I realize it's classified, right? So it's difficult. But can you give us some more feel around that? And then also, how many more opportunities are there out there? Can you share the growth profile? And what percentage of the overall business is classified today?

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

Okay. So let me hit on a couple of points there, Ron. But you're right, a lot of it's classified in terms of its nature. But it's about 25 -- 20% of our total company revenue is classified. And as you know, the classified budgets, both military and national intelligence programs, those budgets have come up over the last 5 or 6 years. They're at a very healthy level. And that does offer some cushion, if you will, as you go into the next several years. If there's more pressure on the nonclassified DoD budget, money tends to move and be well supported in the classified domain. And even the elements of that, of what's in the classified budget, which is around $85 billion, plus or minus, between military and national intelligence programs, the elements are actually moving in a direction which we believe supports a lot of the investments we've made.

So a lot of we focus on is in the space domain, various new technologies for optics, RF systems, driving to larger constellations from prototypes, running a full end-to-end mission solution. I think what's an interesting element of this is, historically, a lot of the space domain was dominated by the intelligence community. But because of the lower cost, faster time to market, more onboard processing of our small satellites, it's opening up new markets within the DoD. So the addressable base for us is actually expanding, and that's helping us quite a bit.

So it's really on the space domain, but there's plenty of other classified opportunities in the -- on the land, in maritime domains as well. We've got a strong position really across all of them. So it's hard to shape them, but it gets back to the comment I made on the strength of C5ISR. And a lot of the things that we do in the classified domain leverage off of that. We hone technologies, advanced technologies, and then you can leverage that benefit into the nonclass environment. And that's been a strategy of the company for a number of years, Ron, and I think it's worked pretty well.

**Operator**

Our final question comes from Rob Spingarn with Crédit Suisse.

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

So Bill, just following up on that, it seems like the competitive landscape for some of your work is changing a bit. There are some public companies in government services that are increasingly moving into comms and EW. And then you have some private companies, especially out on the West Coast, like Anduril and UAVs and SpaceX and smallsats. And the Air Force is also encouraging new contractor formation, business formation. So ultimately, would you accept the premise the competitive landscape is changing? How do you negotiate this in a potentially flattening budget? And how much will M&A factor in?

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

It's a very, very good question. So the landscape is changing. We are seeing greater penetration of some of the Western companies, Silicon Valley companies, SpaceX, you mentioned. As you know, they were one of the awardees of the SDA tracking layer. We could follow what they've done in commercial launch and with Starlink and other things. So they're playing more. There's a number of other companies. You mentioned a few of them. There are some more typical government contractors who are looking to expand what they do into -- from services to other components.

So the market is moving around, and we get it. The way we stay ahead is basically running our strategy, running our game, which is really strong investments and performance in R&D and technology, moving quickly. There's really nobody that's put up a smallsat with the capability we had and the time frame we've done it just in the last couple of years. And I think that's the way we stay ahead. We continue to drive cost out, drive operational excellence, improve quality and meet our program objectives. And I think if we do that and we continue to accelerate the pace at which we can execute on our programs and technologies, we're going to stay ahead. I think that's what we need to do.

Will M&A play a role in that? Maybe over time. Right now, we're focused on integration, our portfolio shaping. But as you go out in time, there could be pieces of other companies or things on the market that could become available to fill a gap in our portfolio. We don't see that today, but that's very positive. In fact, it's probably likely it's going to happen over time. But today, we're focused on running our game, and I think that's been an effective strategy. So Rob, thanks for the question. It was very good. I really appreciate that.

Let me just wrap up from here. The -- and I want to thank again the L3Harris team. They've done a fantastic job of staying focused to meeting our customer commitments. They work very, very hard, and that hard work has led to another quarter of very strong results. We're well positioned coming into next -- into the year-end and into the coming years. And I look forward to our next update. Thank you very much, everybody, for joining us today. Thank you.

**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.