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LHX.N - Q4 2021 L3harris Technologies Inc Earnings Call

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OVERVIEW:

Co. reported 4Q21 non-GAAP EPS of $3.30. Expects 2022 revenue to be $17.3-17.7b and EPS to be $13.35-13.65.

CORPORATE PARTICIPANTS

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PRESENTATION

Operator

Greetings, and welcome to L3Harris Technologies Fourth Quarter Calendar Year 2021 Earnings Call. (Operator Instructions) As a reminder, this call is being recorded.

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

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

Thank you, Rob. Good morning, and welcome to our fourth quarter 2021 earnings call. On the call with me today are Chris Kubasik, our CEO; and Michelle Turner, 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 website, which is l3harris.com, where a replay of this call will also be available.

In addition, following our 8-K filed earlier in the month, we'll be speaking to our 2021 results in our prior 4 segment structure, and our 2022 outlook will be in our realigned 3 segment structure that also shifts pension items to the corporate level, furthering operational transparency.

With that, Chris, over to you.

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

Okay. Thank you, Rajeev, and good morning, everyone. I'd like to welcome Michelle Turner to this morning's call. She is an experienced financial executive with diverse operational experience, including 2 decades in the aerospace and defense industry. She joins us from Johnson & Johnson where she was the CFO of their supply chain organization. I'm excited to have Michelle on the team and look forward to our partnership. So welcome to week 2, Michelle.

Michelle Turner - *L3Harris Technologies, Inc. - Senior VP & CFO*

Thanks, Chris. It's great to be back in the defense industry and to be part of the L3Harris team. I've been following the merger, and I'm excited about leveraging my experiences to further our strategy of being a nontraditional prime.

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

Okay. Let's get started. This morning, we reported our 2021 earnings, and I'm pleased with the result. Our company delivered another solid year of bottom line performance, growing EPS and free cash flow per share by 12% and 9%, respectively.

It wasn't, however, without its challenges as the pandemic stressed our supply chain at a time when budgets remain uncertain. Organic revenues were up 2% for the year, and our margin performance was exceptional as merger cost synergies, alongside E3 savings, enabled expansion of 110 basis points.

Looking ahead to this year, we initiated guidance today that reflects current market conditions. Organic revenues are expected to be up 1% to 3% with steady to rising segment margins. And when combined with the share count decline, we expect EPS of $13.35 to $13.65, reflecting another solid year of growth.

Our free cash flow guide of $2.15 billion to $2.25 billion incorporates current tax regulations, which requires us to capitalize R&D expenditures beginning in 2022 versus the prior practice of annual deductions resulting in tax cash payment increases. Excluding this impact, free cash flow per share growth would have been up by double digits. We'll provide more details on these figures later on the call.

Our focus on both value creation and advancing our strategy of leading as a nontraditional prime has driven our success to date. Moreover, in recent months, we made progress in our focus areas of growing the top line, strengthening our operations and augmenting our disciplined allocation of capital.

Let's start with the top line. With the integration of the company largely behind us, we're progressing on our efforts to grow the business through a 3-pronged approach: first, investing in our capabilities; second, bidding, winning and priming more programs; and finally, expanding our international presence. Our award activity throughout the year demonstrated traction against all 3 of these efforts across all domains.

As a leading defense technology company, we're maintaining our industry-leading R&D spend as a percentage of revenues, with an emphasis on open architecture, multi-function, and software-defined solutions across our broad portfolio of capabilities. This remains instrumental in expanding our revenue synergy pipeline as we reached a cumulative 1 billion in funded orders, including a contract for a classified next-generation system in the fourth quarter.

We are also accelerating momentum with internal investments in the Maritime and Cyber domains. Our leading sensor and integration capabilities for naval solutions on programs, such as the Columbia and Virginia-class submarines, led to awards of several hundred million dollars in 2021. In addition, we received a $100 million sole-source IDIQ from the U.S. Navy for Cyber-hardened electronic attack shipboard systems in the quarter. Our capabilities positioned us for multi-billion dollar opportunities across ship classes and geographies that we're pursuing in 2022 and beyond.

We also expanded our external investments to broaden overall offerings in various capability sets. We're making calculated investments in partnerships and companies so we can bring unique technological solutions to global defense customers. There will be more on this topic throughout the year.

Next, let me update you on the progress we've made as a non-traditional prime, what we call being a trusted disruptor. Our positioning at the nexus of traditional defense players and new experimental commercial entrants aligns well with the U.S. government's desire for agile, advanced and affordable solutions to address near-peer threats. We expect budget dollars to continue gravitating in this direction.

A notable example is within the space domain and the need for responsive satellites that can be rapidly procured and deployed to address a range of threats. We were awarded over $0.5 billion in responsive satellite contracts as a prime in 2021, including the $200 million award for a classified mission within the Intel community in the fourth quarter and we have considerable and exciting opportunities ahead of us.

Turning to International. We continue to see demand for our defensive solutions that are aligned with U.S. export policies and ensure partner security. And with a book-to-bill of 1.1 on solid revenue growth in 2021, our strategy is solid.

We had a strong growth in our ISR aircraft missionization business from a key NATO customer with awards of over $600 million, including $70 million in the fourth quarter, which is part of a broader multi-billion dollar opportunity set we're pursuing in 2022 and beyond.

In addition, our international Tactical Communications business continued to experience robust order activity for land modernization in the U.K., Australia, and a Mid-East country that totaled approximately $500 million for the year and over $200 million in the quarter. This pairs well with the expanding DoD modernization goals, supporting multi-year growth potential for our business.

In fact, just last week, we were awarded a $750 million IDIQ by the U.S. Marines to manufacture the Falcon IV multichannel advanced handheld radio that meets modern crypto security standards, while providing them resilient networking capabilities.

Overall, I'm pleased with the tangible progress we made in 2021 as we delivered a funded book-to-bill above 1.0 and grew our organic backlog by 5%.

Let's pivot to operations. Our integration efforts were quite successful and will wrap up in early 2022. We also continue to drive a performance culture through our e3 program, that pervades the organization and has been key in mitigating the unforeseen challenges related to the pandemic.

We talk about the key components of our e3 program, factory optimization, engineering excellence, supply chain and overhead management. In 2022, we expect these factors to at least offset predicted inflationary pressures for both labor and materials, which we'll look to improve upon as the year progresses.

We're off to a good start with our segment and business consolidation efforts. And over the last 2 quarters, we've delivered margins at or above 19% on a consolidated basis or approximately 16% on a segment basis using our new reporting structure.

We've also reached several key operational milestones this quarter. Within Space, we successfully completed critical design reviews for 2 major responsive satellite programs. First, the Space Development Agency's tracking layer and second, the Missile Defense Agency's Hypersonic and Ballistic Tracking Space Sensor, known as HBTSS. We are gearing up for prototype launches of 5 satellites over the next 2 years.

Within our ISR business, we completed a key flight test and received a supplemental type certificate for the first Compass Call Cross Deck aircraft, the U.S. Air Force's missionized business jet. This strategic aircraft arrived in our Waco, Texas facility in the fourth quarter, where we began the next phase of modification. It is scheduled for delivery to the customer later this year.

Lastly, our WESCAM product line within our electro-optical business concluded its transition to a new state-of-the-art manufacturing facility and delivered a record high number of turrets in the fourth quarter as well as for the year.

Concerning our supply chain, the environment continues to be fluid. For 2022, we expect supply chain disruptions to continue into the first half. As a result, our team is set to continue utilizing the various tools we outlined to address the challenges, such as engaging with lower tiers of the supply chain, accelerating our purchase commitments, utilizing DPAS designations and leveraging smart inventory in selected areas.

Shifting to capital allocation. Our focus remains on maximizing cash generation and strengthening our portfolio, while sustaining a shareholder-friendly approach. Growth in free cash flow per share is a key metric for us. This will remain a 2022 focus as we drive our profit growth, reduce working capital days, continue tax planning and manage capital expenditures. When combined with our share repurchases in 2021 and our current target of $1.5 billion of repurchases this year, we expect free cash flow per share growth of 10%, assuming the R&D tax credit is repealed, contributing to double-digit annual growth since the merger.

Regarding the dividend, it remains part of our balanced capital allocation framework with opportunities to grow it further as we've done in prior years. Finally, with respect to M&A, we'll be opportunistic and use our balance sheet capacity judiciously to complement our capital return program.

Let me now provide details on our 2021 results and the consolidated guidance for 2022, and I'll ask Michelle to fill in the segment and other details on the outcome.

So let's start on Slide 4. I'll refer to all 2021 figures in our prior 4 segment structure given our realignment became effective in early 2022.

Fourth quarter organic revenue was down 1% versus the prior year. CS and AS were down 11% and 5%, respectively, with electronic component shortages in its supply chain, weighing down the tactical business at CS, while AS was impacted by the timing of awards. IMS saw solid 6% growth from continued ISR aircraft missionization activity and the SAS segment was up 2%, driven by growth in our responsive space franchise.

Margins expanded 70 basis points to 19.2%, with the most notable drivers being e3 performance and integration benefits, which offset volume-related supply chain headwinds. We exceeded our internal outlook by 100 basis points through favorable mix related to award timing, continued strong e3 performance and by containing supply chain impacts. These drivers, along with our share repurchase activity, drove EPS up 5% to $3.30 as shown on Slide 5.

For the full year, organic revenue was up 2% and in line with our prior guidance at the consolidated level. At the segment level, IMS and SAS were up 5% and 3%, respectively, while CS and AS were down in low single digits. CS would have been up in low single digits, excluding these supply chain impacts.

Margins expanded 110 basis points to 19.1%, exceeding our prior guidance of approximately 18.75% and we're more than 75 basis points ahead of our midpoint at our initial guide with e3 performance and integration benefits being the primary drivers. Earnings per share grew 12% or $1.35, primarily from operations, synergy benefits and a 6% lower share count that overcame divestiture and supply chain headwinds, enabling us to deliver double-digit EPS for another year.

Our full year free cash flow came in just below the bottom end of our prior guidance range as we consciously built inventory levels to reduce supply chain risk. With this cash flow, along with proceeds from divestitures, we repurchased $3.7 billion in stock and paid over $800 million in dividends, returning about 10% of our market cap to our shareholders.

Next, on Slides 6 through 9, we provide details on segment results, which are largely consistent with prior commentary. In the interest of time, we can take questions in a few minutes so that we can shift our discussion to the 2022 guide.

Starting with the top line. Revenue is expected to be in the range of $17.3 billion to $17.7 billion, implying organic growth of 1% to 3% and reflecting growth in every segment. We expect a weaker first half down in the mid-single digits, driven by continued global supply chain impacts in our product-heavy businesses at CS, along with international ISR aircraft award timing at IMS given tough compares. We expect high single-digit growth coming in the second half of 2022.

Segment operating margins are expected to be 16% to 16.25%, positioning us for another year of expansion and are expected to follow sales with more profit in the second half of the year. This, combined with a 4% lower share count, will result in 2022 EPS of $13.50 at the midpoint. On free cash flow, our $2.15 billion to $2.25 billion guide includes a $600 million to $700 million headwind from the R&D tax policy.

So with that, I'll turn it over to Michelle.

Michelle Turner - *L3Harris Technologies, Inc. - Senior VP & CFO*

Thank you, Chris, and good morning, everyone. I look forward to my engagement with the analyst and investor community at upcoming events and conferences.

I'll continue now on Slide 10 with our 2022 segment details and our realigned 3 segment structure as well as provide additional color on the 2022 EPS bridge and cash flow.

Integrated Mission Systems revenue is expected to be $7.1 billion to $7.3 billion, up 2% to 4% driven by Maritime expansion, classified growth in defense aviation and continued recovery in our commercial aerospace business. ISR aircraft timing from a tough compare is expected to drive a low to mid-single-digit decline in the first half with high single-digit growth coming in the back half of the year. Segment operating margins are anticipated to be within a range of 13.5% to 13.75%, with e3 program savings more than offsetting program mix impacts.

In Space and Airborne Systems, we expect revenue of $6 billion to $6.1 billion or flat to up 2%, driven by our traction and responsive space, along with classified strengths in Intel & Cyber, which we moderated by continued pressure in our airborne businesses as we transition to modernization over the coming years. Segment operating margins are expected to be within a range of 12.5% to 12.75% as e3 program savings offset mix headwinds from key growth programs within space.

Communication Systems revenue is expected to be $4.4 billion to $4.5 billion or up 2% to 4% from modernization demand in Tactical Communications, with supply chain delays netting an expected mid-teen decline in the first half and strong double-digit growth in the back half of the year, along with recovering sales in Public Safety. Growth will be moderated by a flattish outlook in broadband and integrated vision solutions. Segment operating margins are anticipated to be within a range of 24.25% to 24.50% as our e3 program savings will more than offset inflationary pressures within Tactical Communications.

Now turning to the EPS bridge on Slide 11. As Chris said, we expect full year EPS of $13.50 at the midpoint. Of this increase, operations will contribute $0.62, along with a lower share count for $0.60, overcoming headwinds from divested earnings and residual supply chain impacts as well as lower pension income and other items of $0.05.

On cash flow, our outlook reflects a modest working capital improvement, $330 million in capital expenditures and no pension funding. We expect to deploy roughly 100% of our free cash flow to shareholders through $1.5 billion in buybacks barring any strategic M&A.

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

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

All right. Thanks, Michelle. Well done. So to sum it up, 2021 performance demonstrated our ability to deliver strong bottom line results in a dynamic environment. With our 2022 outlook reflecting growth in all key metrics.

With that, Rob, let's open the line for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question is from David Strauss with Barclays.

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

Thanks, good morning everyone and welcome Michelle.

Michelle Turner - *L3Harris Technologies, Inc. - Senior VP & CFO*

Good morning.

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

Chris, could you maybe touch on the budget outlook, what you saw in the fiscal '22 authorization markup. And if that becomes approved, what that might mean for you guys? And as well as what you're assuming in terms of CR? And then last one, a little bit more detail on the individual buckets within SAS in terms of what you're expecting for each of the individual businesses relative to that flat to up 2% for the overall business?

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

Thanks, Dave. Let me start with the CR, the Continuing Resolution. We're assuming a half year CR. Meaning, by April 1, we'll move forward. And I just look at the fact that the President State of the Union speech up moved to March. So I'm assuming he wants to have a budget at that point in time. So that's what we factored in.

Obviously, I think like others, it is a full year CR, will provide a couple of hundred millions of top line headwind, which is not unexpected. Relative to the budget, I think we were all pleased to see that the markup -- I think that could be a good foreshadowing of the future. We don't have a FYDP yet, but we continue to think aspirationally that mid-single-digit growth is something that we can achieve.

As I've said before, I really like our portfolio, the fact that we're in all these domains. And as I laid out in my prepared comments, we continue to invest IRAD to grow. We're working with some of these new commercial entrants. We're priming and bidding more, and international has been a good story. So that's how I see the budget rolling out. Look forward to more information there.

When we go to SAS, the components of SAS, there's focus on the key sectors. We see -- continue to see space growing in the mid-single digits. We were probably a little more bullish back in October, but there continue to be delays in contract awards, either directly or indirectly related to the CR.

So Space, I see mid-single digit this year, Intel & Cyber is one of our hot businesses, continuing to grow high-single digits. So that's maybe a little better than what we had told you in October. Mission Networks, which we moved from AS into SAS as we collapsed the segment, has been and always continues to be in that low-single digit growth, mainly doing work for the FAA.

But what we're seeing the decline is in our air sectors, Mission Avionics and EW combined. And that's really almost entirely tied to the F-35 program. As you know, the TR3 development is rolling off and production is ramping up. So as I quantify it, I think I've said before that 2022, we're going to have about $150 million decline in revenue just attributed to the F-35 program. We'll see that start to return to growth in '23. But this is just a roll-off of development on TR3 and then moving into production on the 3 components that we provide to that aircraft.

Operator

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

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

Thanks, good morning Chris and welcome Michelle. Chris, maybe you had $0.18 at least baked into your '22 guidance for the supply chain adjustment, and that's obviously better than the $0.29 in '21. So maybe just your confidence around the supply chain? And what kind of visibility, what's baked into the $0.18? And then just also, Michelle made a comment about just modest working capital improvement. Maybe you could just discuss a little bit what's behind that?

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

Yes. Thanks, Peter. No, relative to the supply chain, we think we're doing a pretty good job over the last maybe 6 or 9 months, as I mentioned, with getting more visibility into the second, third tier supply chain. We've invested in tools that give us that visibility. So we've talked previously about a $200 million revenue headwind in '21. We see that continuing in the first half of 2022.

And I think where we've been maybe a little more conservative than in October as we see that recovery bouncing back in the second half of '22 and then also in early '23. So think of that about a $100 million headwind each quarter in 1 and 2, and then maybe getting $100 million back in the second half and $100 million back in early '23 from a revenue. And of course, that brings along the related operating income.

So that's how we see it. But it's a dynamic area. It's mainly been focused on electronic components. But we're monitoring it and managing it at all sectors and all segments. And it feels like we've turned the corner, but we'll keep you up to date kind of quarter-to-quarter as things change.

So relative to working capital, as we try to get to the guidance, we ended the year at 52 working capital days. We'll bring that down a couple of days as we go to that $2.8 billion to $2.9 billion guide. Michelle?

Michelle Turner - *L3Harris Technologies, Inc. - Senior VP & CFO*

Yes. And just to add a little bit more color on the working capital. If you think about it, we built smart inventory at the end of 2021. And so we expect a Tactical Communications comes back in the second half. We'll bring some of that down. And then there's also an advantage from an ISR perspective on advanced payments that we're anticipating at the end of the year as well. So it's going to help free cash flow within 2022.

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

And I'll just throw in, Peter, just our definition of supply chain is pretty broad. We're throwing in the labor. We're throwing in material and we're throwing in inflation. So all that contributes to the $0.18.

Operator

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

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

Good morning, thank you. In Communication Systems, there you've clearly been hit by some issues around COVID, supply chain, we've also got inflation, that would be hitting fixed price -- commercial fixed price contracts there.

If you were to think of 2022 without these headwinds having been there, what would you see Communication Systems looking like in terms of growth margin? And is this something, given that there's a headwind there, is this something that we should see all coming back when we move out to 2023? Or is there just going to be some lost demand and margin here?

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

Yes. Doug, that's a great question. Something we spend a lot of time looking at. I don't see any loss. I think this is just a timing issue. And as we were looking through the business, just the other day, I mean it's had a great book-to-bill in 2021. Now some of that is due to less revenue, but we have a record backlog, an all-time high in backlog, which is an indication that we continue to win new business.

And I mentioned just the marines recently, which is a winner-take-all competition. So we're very excited to have won that $750 million IDIQ. And throughout '21, I think we were pretty clear in all the head-to-head competitions we won the majority share. So the demand is there. The modernization is happening that's in our backlog. And everything indicates to be going quite well.

What we would have had without supply chain risks probably would have been 300 or 400 basis points more growth as these things slip into '22. And as I mentioned, potentially '23, depending how the supply chain plays out. So at a high level, that's kind of how I see tactical.

You asked about Communications Systems in totality. So the PSPC business, a lot of that is tied to state and local municipalities. As we said, that ought to rebound as the budgets get back in place. And we had some key wins last year, but we expect that to continue to grow.

BCS, our Broadband Communication Systems in Salt Lake. A lot of that is still tied to the next-gen jammer start-up and some new opportunities that they're pursuing. So we feel pretty good about our communications. I've got, for the full year '22, Tactical up mid-single digits, maybe even a little better. BCS and IVS are kind of flattish area and PSPC should bounce back with the budget improvement.

Operator

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

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

Thank you. Hi Chris and welcome, Michelle. Maybe I wanted to bridge that growth from 2022, the 1 to 3. Chris, you've talked about it in a bunch of moving pieces, some of the CS softness, Airborne and F-35, you mentioned versus the mid-single-digit growth profile you have. And then maybe just a follow-up on the SAS growth, perhaps being softer. What are you seeing there in terms of trends longer term?

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

Yes. Thanks, Sheila. We had said in October that would be in the lower-to mid-single digits, which best I can tell everybody is interpreting is 2 to 4 and now we're at 1 to 3. So it's a close call there. And again, I'm the accountable exec here for giving the guidance with Michelle and my team. But I really tried to look at the current market conditions, and everything I see from not having a budget, a CR and supply chain risk, it seems appropriate to guide.

So I don't see this as a major change from 90 days ago, but I'm trying to give you the visibility. I mean, basically, the only thing that really changed. And I know it gets a little complicated as we went from 4 segments to 3, but we can talk about that later. But we filed more than enough documents with the SEC and our web charts trying to bridge it. But IMS and CS basically did not change from October. Those were kind of in the 2% to 4% range.

As I said, the big change is in SAS, and we can argue how big a change that was. But clearly, downward pressure on the top line. And as I mentioned in an earlier comment or response, most of that is driven by the air domain and F-35 specifically.

The good news is that's a well-known program that everybody has visibility into. So we have confidence that as we negotiate Lots 16 and 17 and prepare for the cut in of our technology on Lot 15, that there's a lot of certainty and predictability in our revenue stream. So we do see '23, '24, '25 coming back.

Longer term, just within SAS, I mean I really like what we're doing in the Space business, both on the satellites and the ground stations. We pretty much control our own destiny. You've heard us talk about the missile defense area, and we'll be launching 5 prototypes in the next 2 years.

And then I think there'll be further opportunities to down-select from 2 to 1. And if we perform and have success, there could be billions of dollars of opportunities. So I really like where we are in Space with the responsive SATS.

We still work with a lot of our industry partners, providing them payloads for the exquisite SAT. And we've been successful in winning a lot of ground stations. So I'm excited about the space.

Intel & Cyber continues to grow. That's an international business doing work with the Five Eyes countries. It's probably the hottest market that we have. And again, I think long term, there's just going to be more and more. Mission Networks, we have a competition, a recompete, coming up for the FAA and hopefully sometime this year, but that continues to be a good business and solid and steady.

And then it's really all about air and the F-35 program, the EW capabilities for the F-16. Internationally, we're on the B-52, and that's a complete overhaul relative to EW capabilities. And then we think we're well positioned on next-gen aircraft, but all that is classified as you know, and more to come as those decisions and down selects are made. So longer term, SAS, just like the other 2 segments, should be able to grow. And that's our plan.

Operator

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

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

Thanks so much, and good morning everyone. Chris, you commented about -- so you had a good year on the export side in 2021. I was wondering what your expectations are for 2022? Whether these various tensions around the world, particularly in Eastern Europe could have some benefits for orders?

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

Yes. No, Robert, good point. I mean for the last couple of years, our international business has been growing double digit. And I think our strategy, which is somewhat unique, I think, compared to others. We have focused countries, 10 focus countries, where we have executives full time in the countries. And then we use our distributors and reps more for the product. So it seems to be paying off, and we've been able to see that growth.

I mean beyond '22 and beyond, we're seeing a mid-single-digit growth. But as you said, anything can change rather quickly, especially in the European area. So our Tactical Communications business is generally a quick turn business, and I think could be pretty opportunistic as well as our night vision business.

So we're always available for quick turns when tensions get tight or there's new demand or requests. So I think there could be some potential growth upside that we haven't completely factored in. And again, a lot of our products that I allude to are more on the defensive side.

So ISR situational awareness has always been key. We've migrated to the BizJets and we've talked about the success of that strategy and programs in NATO and the Mid-East. And Again, we have multiple other countries we're working with over the next few years.

And then we also, being somewhat -- I hate to say, platform agnostic, but we're working with different parts of the world. We have King Air ISR capabilities. We have large aircraft and BizJets. So they're all working reasonably well. We'll let you know as things move forward in the international world, but optimistic for 2022.

Operator

Our next question comes from the line of Mike Maugeri with Wolfe Research.

Michael James Maugeri - *Wolfe Research, LLC - Analyst*

Good morning, thank you. Following on Peter's question from earlier. Sort of taking a step from the '22 free cash guide out of year. Is $3 billion or better what we should be looking at for 2023? And is free cash growth in 2023 all earnings growth? Or where, if we can, should we expect to see you to continue to generate working capital efficiency out in '23?

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

Yes. Thanks, Mike. Let me take that in reverse order. We absolutely expect to continue to see working cap improvement. We've talked aspirationally of getting down to the low 40s. We ended the year at 52 for 2021, 52 working capital days. We should be able to take out a few more days in '22, which still gives us a long runway for '23 and beyond.

So notwithstanding the R&D item, which everybody is confident will be repealed or deferred for 4 years, but hasn't happened yet. So we figured we'd just give guidance, give you the pieces. But we've effectively kind of guided to a $2.8 billion to $2.9 billion FCF for 2022, if you use the midpoint of the R&D $600 million to $700 million.

So that should put us on track to get close or around the $3 billion mark in 2023. Starting with top line growth, which will generate more OI and earnings. And then, of course, the working capital.

I tried to look at maybe implied in your question, if we go back a couple of years or 2.5 years, we talked about getting to $3 billion in 2022. And obviously, coming up short. Just thought I'd hit that head on. I mean, clearly, we talked about some of the supply chain decisions we've made, which was a little bit of a headwind.

At that time, we didn't know there'd be a stimulus bill that's affected social security payments. So many of us defer those payments back in 2020 for the rules, and now we're paying them back. So we have almost $100 million of social security payments that we have to pay in 2022 that's in our guidance. And we divested more businesses than we initially modeled.

So I continue to like to look at free cash flow per share. I went back to day 1. And while we don't really disclose or publish it, we had a plan of $14.50 on free cash flow 2.5 years ago in 2022. If you do the math today, I'll do it for you, we're at $14.80. So on our free cash flow per share, we're ahead of where we were kind of be 2.5 years ago, even though we're coming up short on the $3 billion. So hopefully, that might make sense and gave you all the answers to your question.

Operator

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

Richard Tobie Safran - *Seaport Research Partners - Research Analyst*

Michelle, welcome to the call. Once again, you're highlighting e3 as a tailwind in '22. I was curious as to how much runway you think you have left with respect to e3 cost savings?

You've been reporting the e3's benefit to margins for quite some time. And I was just curious if you think longer term, you have continued room for meaningful improvement? In your answer, if you could get a bit more specific about where you think the additional benefit comes from?

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

Thanks. Great question. And the answer is obviously going to be yes. I think the system and the methodology we've put in place has been a success, and we expect it to continue.

I mean to give you some details --. Historically, I think a lot of these continuous improvement programs start out focused on the supply chain, which is a good thing in direct labor optimization, and we do that. But we've taken a much broader approach, and one area is just the ability to improve our yield. So we're looking at our rolled throughput yield at all of our facilities.

They come in different sizes and different flavors. But if we can obviously improve those, yields 5 or 10 basis points, it just contributes to the bottom line. This year, we collapsed from 4 segments to 3. That brought us savings, any savings I get, I put under the e3 umbrella. But that brings about some savings.

When we first merged, we had 19 sectors rolling up to these 4 segments. Today, we're down to 14. We might have sold 1 or 2. We collapsed a couple more. So we're getting synergies in the organizational structure. We've been investing in systems. We're putting in a manufacturing execution system in one of our large facilities that have a lot of manual and paper processes. Those are now getting updated, and everything is getting to be electronic. So I think that is already starting to show benefits, and the system is not even fully implemented yet. And we'll roll that out to other facilities and factories.

We have a process that we call our perimeter cost, where we look at the entire cost of each and every facility. And we look where the big bucks are, and we target our e3 projects, of which we have hundreds at those larger dollar items. I mean this comes down to a lot of this links in with our ESG or environmental initiatives and whether it's energy and utilities, all those types of things. I think, are maybe some specific examples.

Still trying to figure out, as I said, and I think everyone said, if we return to work and do things the way we used to pre-COVID, we've missed an opportunity. So I think I've told you -- before the merger, 98% of the workforce came to work every day, and that was kind of the norm. And today, we're at about 70%, full-time on-site about 20% hybrid, 10% remote. So that also brings different savings and facilities and such.

So we're looking at all those things, Rich. To be specific on e3, but in a broader sense, I think implied in your question was the overall segment growth. So not within e3 is the recovery of the supply chain, more international sales at higher margins, as an example.

I mentioned F-35 transitioning out of development into production. I think we all expect higher production margins than development margins. And we still have a little commercial business with the aviation and PSPC and as those turn around. So when I look at all these things, it's hard not to see where we can continue to grow margins for the foreseeable future.

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*

Hey Chris and welcome, Michelle.

Michelle Turner - *L3Harris Technologies, Inc. - Senior VP & CFO*

Thank you.

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

Wanted to just ask about capital allocation. So you've done a lot of divestments. Obviously, you're guiding $1.5 billion of buybacks. What's the appetite for M&A? Again, do you see any bigger opportunities presenting themselves? Or do you think it's going to be more of a tuck-in variety?

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

Yes, good question. Well, first of all, the $1.5 billion of buybacks directly tied into the free cash flow guide. If the R&D matter gets resolved, I'd formally increase the free cash flow guidance, bring up the buyback to $2 billion, just to be clear on that one.

Yes, there's absolutely an appetite for M&A. We have a new leader in our strategy and M&A organization and we've got a process where we've been looking strategically as to where we might want to make acquisitions. You said big, it's always hard to quantify these adjectives.

I mean, having come from L3, I'm probably not a huge fan of lots of little $50 million, $70 million, $100 million deals. It just causes a lot of challenges with integration and such. I think the multi-billion, $5 billion and beyond, there aren't many targets, and that's a lot. So I'd say $0.5 billion, $1 billion, $1.5 billion type size to probably call those medium kind of makes sense.

So as you know, there are a whole lot of opportunities out there, but we're in discussions proactively and reactively. Nothing on the horizon or foreseeable. I mean, if we make an acquisition in 2022, that would be great. If we don't, we don't. It's not like a burning platform, but we're running a disciplined process.

We initially start by looking at things strategically. Followed by operationally, if we were to buy it, what are we going to do? How are we going to integrate it? How do we keep the workforce? Do we move people to keep them separate? What are the synergies?

I think with the big merger we just did, we have a lot of talent and skills in figuring out revenue and cost synergies. And then financially, working with Michelle, we'll figure out the hurdle rates and the cash returns and the more traditional piece. But that would be the order that it goes in.

I'll just comment. I think a lot of people have been asking about some of the recent news surrounding Aerojet Rocketdyne, and that decision's impact on the industry. And I know there's different commentary out there, but I'm not familiar with the details of that decision or the rationale, but it seemed to be specific to vertical integration.

So relative to what we're thinking about, I don't expect any opposition or hurdles if and when we get to the point where we need to have approvals. And that's something we would consider and evaluate before moving forward. But I think it's business as usual from my perspective, for L3Harris relative to our portfolio, and the things we might consider down the road.

Operator

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

Elizabeth Grenfell - *BofA Merrill Lynch - Research Analyst*

It's actually Elizabeth on for Ron this morning. I just wanted to follow on to the last question, I think you hit on a little bit. But given what we've seen in the new administration, do you think in general, the environment for defense M&A has changed? So you said not for you, but maybe just in general, do you think it's changed? In many ways, do you think big defense M&A is over?

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

Yes. No. Elizabeth, I would think these decisions and policies change administration by administration. So with the current administration, it would appear that, that big M&A, if that was considered big, is potentially over, at least until there's a change in administration at some future point who may or may not have new policies.

So as I said, I haven't really looked at and probably won't have the time to figure out what the specific case was. But I think it's always a predisposition for more competition and less vertical integration. And when I look at the L3Harris merger, that went through relatively quickly. It was complementary. We're now in all 5 domains.

It made perfect sense. It was just a very small business that wouldn't allow for competition. So it was divested. So I think you can look at these things pretty quickly and figure out if they're going to go through or not. And I continue to believe that from our perspective, there will be plenty of opportunities.

I think at some point, there's a reluctance to have really big guys get bigger. So I kind of like where I am relative to the real big guys. So that's how I see it from my perspective. We're going to run our playbook and see what happens. And others either will or won't be in the game, but I like where we are.

Operator

Our next question is from the line of Robert Spingarn with Melius Research.

Robert Spingarn - *Melius Research - Research Analyst*

Welcome, Michelle. Two quick things. Chris, on the talent side, how difficult is it to get people? And what kind of labor inflation are you seeing? And how is that impacting fixed-price contracts?

And then, Michelle, just on the tax situation, if you could give us the mechanics? We've been talking about this with everybody for a week. But what are the mechanics of this higher tax rate? Will you pay cash taxes at the higher rate quarterly until you find out what's going to happen and then it gets refunded? So if you could just clarify that.

Michelle Turner - *L3Harris Technologies, Inc. - Senior VP & CFO*

Yes. So I'll start from an R&D perspective. And you're right, there has been a lot of fluidity in the calls this week. And so just to reiterate what we have in our guidance. So our free cash flow assumes with the $2.15 billion to $2.25 billion, it assumes $600 million to $700 million related to the R&D tax amortization.

And I think it's important to note that this is the tax law that's in effect today, right? So as part of the 2017 Tax Cuts and Jobs Act. And so barring a repeal or deferment, this will have an impact on our results. And so for us, it's about $2 billion over 5 years, and then it goes away. So that will go down to 0.

I think to the point about paying it, not paying it, that's certainly something that we're looking at right now. But just to give you a sense of kind of the fluidity you're seeing through the other primes, it really comes down to a couple of different things. One is, clearly, you have everybody understands what they're paying from an IRAD perspective. But where the interpretation comes in is around the CRAD. And then what you apply to the CRAD in terms of overhead and fringe on top of that.

And so that's where you're seeing the ranges across each of the different peer companies. And so we're going to work through in terms of what the cash payments will look like, and that's discussions that we're having internally right now. But I think what's more important if we were to take this back to a macro level, it's important that we continue to press on the real issue here, which is we need to get this repealed or we need to get it deferred. It is going to be a huge impact from an overall U.S. competitiveness perspective. And so ensuring that this gets delayed, is important to continue to drive the innovation that we think about and keeping the U.S. at the cutting edge of innovation.

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

Thanks, Michelle. And then Michelle and I have spent a little bit of time with the tax department in her first week. And it's just a world class organization. And when you look at the metrics, whether it's our effective tax rate relative to others, if you look at our R&D tax credit, which is not what we're talking about now relative to others and the percentages, I think we just got a great organization there.

And we're seeing that in our financial results. So going to the talent question, which is a great question. Actually, in 2021, we hired 8,000 new people. And I talked about COVID earlier, and we opened the office and kind of got back to whatever the new norm was in December.

And it was interesting because at that time, half of those employees, 4,000, have never even been to a L3Harris facility. We FedEx them laptops and do everything via Zoom. So talking about a new kind of world here. But we've hired 8,000. We're probably going to hire another 8,000 this year.

We're seeing a little bit of inflation or most of the inflation is at the entry level. We haven't really seen that at the higher levels or the executive levels yet. Maybe that comes later in 2022. But a lot of this depends on geography, and half our workforce seems to be in Florida and Texas. And those seem to be places that people enjoy living and working or moving to.

So we've been a little more fortunate maybe just based on the geography. We get about 1,000 new college grads a year. We have a whole process as to how to recruit those through key schools, focused schools. And we've maintained our internship program the last 2 years, even during the pandemic. Unfortunately, those were all remote. But I think I told you back in 2020, we extended offers, we honored those offers. All those things kind of contribute and pay off.

And my goal and the team's goal is to have an engaged workforce that's excited to come to work every day and help with our mission. We do periodic engagement surveys to track that. So I think we're doing everything we can. A big believer in flexible work schedules. And we've got a whole variety of ways to have the workforce stay engaged and contribute.

But clearly, a watch item. But so far, so good. I mentioned F-35 earlier and some of the challenges that, that program has had. We've been fortunate to have a highly engaged workforce holidays, weekends, over time and been able to maintain that staffing even through the pandemic and meet our milestones.

So hopefully, that helps, Robert.

Operator

Our next question is coming from the line of Michael Ciarmoli with Truist Securities.

Michael Frank Ciarmoli - *Truist Securities, Inc., Research Division - Research Analyst*

Welcome, Michelle. Chris, I just wanted to go back, I think, to maybe Sheila's question on what really changed in SAS? And maybe even dovetailing in kind of programs that are being impacted by the continuing resolution. But I think you kind of called out the biggest, being the F-35. And it seems like that would have been a known sort of headwind, I guess, in October.

So were there any other big specific programmatic changes or programs that you can't start up because of the continuing resolution that are weighing on that kind of growth rate?

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

Yes, good question. No, I mean, the F-35 is a pretty dynamic program, right? So we follow the prime and as quantities and strategies change relative to what's going to be retrofitted and what's not and such, and I'm talking about all F-35, which we have crypto capabilities. We have displays. We have bomb racks and of course, TR3.

So it's a broad portfolio of just under $1 billion of revenue. So it changes on a regular basis. I can assure you. But it's a fair point. We didn't have it at $150 million last time we talked.

But relative to the CR, this probably won't be a satisfying question. The fact that we have a CR has caused the contracting organization and our customers just to defer and delay making awards. Which is kind of an indirect impact.

I mean there are programs that have been awarded that the follow-on work is limited to the prior year dollars. The new work can't get started. So these aren't getting awarded. And we just see a huge backlog of things that just haven't been awarded.

So a lot of these are in the space of the classified arena. And most of the space work is domestic. They don't have a big international footprint as an example. Electronic warfare and Mission Avionics, again, most of those programs we're supporting an OEM. So we need them to go ahead and get their orders before putting us under contract.

So it just feels like a big delay. I think as soon as we get a budget, as soon as there's more certainty, things will kind of open up and then the floodgates will open. But until now, we're probably erring on the side of conservatism. But like I said, based on the current conditions, we're standing by this guidance until things change for the better. And if and when that happens, we'll update you accordingly.

Operator

Our final question comes from Pete Skibitski with Alembic Global.

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

Chris, I had a quick program question. I was wondering if you could update us on what the Navy and Air Force's plans are to replace the E-6Bs, E-4Bs? I think that was supposed to be a combined program at one point. I don't know where it is today, but I also know it's kind of right up IMS's alley in potentially a pretty big opportunity. So I was just wondering what your thoughts are on the timing and the sizing of that? And if that's something that DoD is actually going to fund?

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

Yes. Yes. No, it's right up our alley for the ISR IMS organization. But also those programs, as we do more and more cross-segment work involves BCS and some of the comms team as well. So the one thing I think we're doing a much better job on and what we've been doing since the merger is pulling in other sectors and other segments and looking at some of these things holistically.

So yes, IMS will take the lead, but we'll be able to pull through. The E-6Bs, I think that's one that we were hoping for last year, and it continues to slide. We'll have to follow up with you with the exact dollar opportunities. It's on our priority of pursuit list to get both of those programs. But I think it's a '22 program.

But with all the things that I talked about, it could slip into '23. So -- we'll get you more information on that one, Pete.

All right. Well, look, before we sign off, again, I want to welcome Michelle. It's obvious, she's hit the ground running. I'd also like to acknowledge the dedication and hard work and perseverance of our 47,000 employees worldwide. We've continued to perform well in a constantly changing environment. They've had to deal with different work schedules, locations, vaccine mandates, all while navigating through a pretty large merger of equals.

So -- at the end of the day, we have a great team here at L3Harris. I'm excited about the opportunities ahead as our company enters the third year post merger. Look forward to meeting and talking with everyone over the next few months, introducing Michelle. And then we'll be back in April for our first quarter call. So thank you all for joining. Have a great day.

Operator

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