THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

LHX - Q4 2019 L3Harris Technologies Inc Earnings Call

EVENT DATE/TIME: FEBRUARY 04, 2020 / 1:30PM GMT

OVERVIEW:

Co. reported 4Q19 non-GAAP EPS of $2.85. Expects calendar year 2020 organic revenue growth to be 5-7% and EPS to be $11.35-11.75.

CORPORATE PARTICIPANTS

Anurag Maheshwari *L3Harris Technologies, Inc. - VP of IR*

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

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

Rajeev Lalwani

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

CONFERENCE CALL PARTICIPANTS

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

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

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

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

Jeffrey Joseph Molinari *Cowen and Company, LLC, Research Division - Research Associate*

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

Matthew Higgins Sharpe *Morgan Stanley, Research Division - Equity Analyst*

Michael Frank Ciarmoli *SunTrust Robinson Humphrey, Inc., Research Division - Research Analyst*

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

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

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

Peter John Skibitski *Alembic Global Advisors - Research Analyst*

Richard Tobie Safran *The Buckingham Research Group Incorporated - Director of Equity Research*

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

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

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

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

PRESENTATION

Operator

Greetings, and welcome to the L3Harris Technologies Fourth Quarter Calendar Year 2019 Earnings Call. (Operator Instructions)

As a reminder, this conference is being recorded. It is now my pleasure to introduce your host, Rajeev Lalwani, Vice President, Investor Relations. Thank you. You may begin.

Rajeev Lalwani

Thank you, Michelle. Good morning, everyone, and welcome to our Fourth Quarter Calendar Year 2019 Earnings Call. On the call with me today are Bill Brown, our CEO; Chris Kubasik, our COO; Jay Malave, our CFO; and Anurag Maheshwari.

First, a few words on forward-looking statements and non-GAAP measures. Forward-looking statements involve assumptions, risks and uncertainties that could cause actual results to differ materially from those statements. For more information, please see the press release, the presentation and our SEC filings. A reconciliation of non-GAAP financial measures to comparable GAAP measures is included in the quarterly materials on the Investor Relations section of our website, which is l3harris.com, where a replay of this call will also be available.

To aid with year-over-year comparability following the L3Harris merger, discussions will be on a combined basis with prior year results, along with year-to-date and first half 2019 results, reflecting a combined L3 and Harris as if the businesses have been operating together during those periods. With that, Bill, I'll turn it over to you.

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

So thank you, Rajeev, and welcome to your first earnings call. Good morning, everyone. .

Rajeev has recently taken over as Head of Investor Relations and joins us from Morgan Stanley, where he was Executive Director of Equity Research covering aerospace and defense, and we're pleased to have him on the team. I'd also take this opportunity to thank Anurag as he transitions to a new opportunity back home in Singapore. Anurag did a truly exceptional job as Vice President of Investor Relations over the past 3 years in communicating our story as we've embarked on a significant transformation in introducing your company to a broader base of investors. And he was appropriately recognized a few months ago by Institutional Investor as the #1 IR professional in the aerospace and defense sector. Anurag, we wish you well. You left big shoes for Rajeev to fill.

So earlier today, we reported strong fourth quarter results with non-GAAP EPS of $2.85, it's up 28% on 10% revenue growth. Overall company margin increased 240 basis points or 17.3%, and free cash flow was strong at $831 million. These results capped an exceptional first 6 months as a newly combined company in which we grew revenue and expanded margins in all 4 segments, outperformed on all guidance metrics and delivered earnings per share growth of 27% for the second half and calendar year with full year free cash flow of $2.46 billion.

Total company-funded book-to-bill was 1.02 for the second half and 1.04 for the full year, driving funded backlog of 5% and setting us up for continued top line growth in 2020. We continue to execute well against our strategic priorities. And I'll start with an update on our progress on Slide 4, then Chris and Jay will provide details on segment results and calendar '20 guidance.

First, integration is progressing ahead of plan. And in the first 6 months since close, we delivered $65 million of net synergies or $15 million higher than our previous guidance. This momentum, along with a well-defined path to generate $180 million of cumulative net savings in 2020, give us confidence in achieving our $300 million net savings target or $500 million gross earlier than anticipated and about a year ahead of plan.

Second, while integration projects are well underway, we continue to make great progress on lowering cost, driving productivity, and improving working capital performance as part of our normal operational excellence program called E3, and you're seeing the benefits in our reported results. Since June, we've lowered working capital by 8 days, primarily from better inventory management with plenty of runway ahead of us. In addition, we've established common operating metrics and set improvement goals at all major sites with a rigorous reporting and review cadence put in place. I'm very pleased with the way the teams have leveraged E3 to deliver immediate benefits that have helped to offset mix and investment headwinds. And I'm confident this focus will drive organic margin expansion longer term.

Third, we continue to invest smartly in technology and innovation in anticipation of customer needs to support future growth. In the past 6 months, we've analyzed our combined R&D spend of about $700 million with a focus on improving both the efficiency and effectiveness of our investments. Since the close, we reduced the number of R&D projects by about 30% and redeployed about 10% of our spend from overlapping or discontinued projects to focus on areas where we can grow revenue, increase share and expand into adjacencies, including supporting new-found revenue synergy opportunities. We've now submitted 23 revenue synergy proposals, and that's up 9 from last quarter. And of the 8 that have been awarded, we were down-selected for 5. If we're successful on these 5 and that they fully develop, we estimate a lifetime revenue potential of about $2 billion.

Our fourth priority is reshaping our portfolio to focus on high margin, high growth, technology-differentiated businesses where we can win and generate attractive returns. While the effort is ongoing, we've made progress and just announced a definitive agreement on the sale of our airport security business for $1 billion to Leidos, which we expect to close by midyear, with net proceeds used to repurchase shares and offset dilution. Although this is the first and largest transaction we're contemplating, our portfolio shaping process is ongoing and may ultimately result in 8% to 10% of total company revenue being divested over time. And as we've said before, this will not impact our $3 billion free cash flow target in 2022, and we'll continue to communicate transactions as they occur.

And finally, our fifth priority is to maximize free cash flow with shareholder-friendly capital deployment to drive value on a per share basis for our owners. In the second half, we generated free cash flow of $1.45 billion or $110 million higher than guidance, driven by better-than-expected working capital performance while returning $1.8 billion to shareholders. We're well on track to deliver on our commitment to buy back $2.5 billion in shares over the first 12 months post-merger, with $1.5 billion recently completed in the stub period and $1 billion planned for the first half of 2020.

Overall, I'm very pleased with the progress we've made as a newly combined company and expect to build on those momentum in 2020 as we leverage a well-funded defense budget, benefit from our increased scale and continue to execute against our strategic priorities.

For 2020 guidance, we expect earnings per share of $11.35 to $11.75, up double digits on organic revenue growth of 5% to 7% and free cash flow of $2.6 billion to $2.7 billion, implying free cash flow per share of approximately $12.25 at the midpoint. In line with our commitment to shareholders, this year, we plan to return more than $3.5 billion through share repurchases and dividends, which we're able to do as a result of strong operational performance, accelerating cost synergies and successfully executing on our portfolio shaping strategy.

And with that, let me turn it over to Chris to provide an update on operational and segment financial performance. Chris?

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

Thank you, Bill, and good morning, everyone. Let's turn to operating results by segment on Slide 7.

Integrated Mission systems grew revenue 10.2% for the second half of '19 and 11% for the calendar year. This was driven by strength in our ISR missionization business from growth on several key programs, including Compass Call prospects, Australian Peregrine and presidential aircraft recap, along with the ramp in the Wescam turret systems, both domestically and internationally.

Segment funded book-to-bill was 0.96 for the second half and 1.06 for the year as we leveraged our incumbent position with Big Safari, booking more than $1.7 billion in orders this year. Orders also outpaced sales in our electro-optical and maritime businesses.

Second half segment operating income was up 29%, and margins expanded 200 basis points to 13.6% from cost synergies, merger-related accretion and operational excellence. This, combined with solid first half performance, resulted in full year margin expansion of 130 basis points to 12.9%. A key achievement from the last quarter was obtaining the certificate of airworthiness in our ISR business on our fourth and final Peregrine aircraft. Through this multi year effort, we modified G550s with next-generation electronic warfare capabilities for the Royal Australian Air Force. Our strong performance and customer focus positions us for continued international growth in our missionization business into 2020 and beyond.

On Slide 8, Space and Airborne Systems revenue increased 15.7% in the second half and 16% for the year. This strong performance was driven by our production ramp and increased content on long-term platforms, including an F-35, F-18 and F-16 as well as sustained growth in classified programs. Funded book-to-bill was solid for the first 3 quarters with a downshift to 0.74 in the fourth quarter due to timing, resulting in a second half book-to-bill of roughly 0.9 and full year of 1.01.

Segment operating income was up 21.8%, and margin expanded 90 basis points to 18.7% for the second half, driven by strong program execution and integration savings. This resulted in full year margin of 18.5%. At SAS, we have achieved several major milestones in our responsive satellite franchise this past year, including new key wins for additional satellite buys. These milestones are a testament to our innovation and strong program performance and opens new opportunities with multiple classified customers, reinforcing our credibility in the market as a responsive mission prime.

On Slide 9, Communication Systems revenue was up 10.4% for the second half and 11% for the year. For both periods, DoD taxable was up more than 30%, driven by modernization demand, which more than doubled versus the prior year. Integrated Mission Systems grew double digits from a ramp in the ENVG program, and public safety continued to gain share with state and federal agencies. Order momentum was broad-based with a funded book-to-bill above 1.0 in every sector during the second half, resulting in the overall segment at 1.15 for the half and 1.06 for the year. A highlight was the considerable progress we made on DoD tactical radio modernization programs and production awards from the Army, Marines and SOCOM.

We received the second low rate production order for 2 channel radios from the Army with nearly 2/3 share awarded to us, reflecting the Army's confidence in our capabilities, performance and affordability. Segment operating income was up 15.7%, and margin expanded 100 basis points to 22.9% in the second half from integration savings and strong operational performance, partially offset by the mix impact from the ramp and tactical radio modernization programs. This resulted in a full year margin of 22.3%.

Lastly, on Slide 10, Aviation Systems revenue grew 3.5% in the second half and 2% for the full year, driven by growth in defense aviation products, partially offset by the previously announced competitive loss on the C-17 training program. Demand for full flight commercial simulators picked up in the quarter with bookings of 6 units, bringing the calendar year total to 10. This order momentum, along with continued demand in defense aviation products, resulted in second half and full year funded book-to-bill of 1.11 and 1.05, respectively.

Segment operating income was up 68% and margin expanded 550 basis points to 14.2% for the second half from improved performance, merger-related items and cost synergies, partially offset by mix. This resulted in full year margin of 12.4%.

In our Mission Networks business, our system went live in India on an air traffic control contract that mirrors our success with FTI in the U.S. The network operations and security operations control centers became fully operational in the fourth quarter, and the first service connectivity was established in December. An additional 80-plus services are anticipated to be activated in the first quarter as we continue to make progress on the first-ever international FTI contract, establishing our position as a partner of choice globally.

So overall, a solid first 6 months, and I'm confident in our outlook for 2020. With that, I'll turn it over to Jay.

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

Thank you, Chris, and good morning, everyone.

I'll begin with a recap of fourth quarter results, where revenue was up 10% and EBIT increased 28% on higher volume, operational efficiencies and integration savings. This resulted in margin expansion of 240 basis points to 17.3% and EPS growth of 28% or $0.63, as shown on Slide 11. Of this growth, $0.56 came from higher volume, solid program execution and integration synergies as well as $0.15 from pension and elimination of L3 intangibles, partially offset by an $0.08 net headwind for tax, share count and interest.

At the same time, free cash flow was very strong at $831 million for the quarter from better-than-expected collections. And for the full year, EPS was up 27% or $2.16 with $1.72 driven by operational improvement and cost synergies and an additional $0.44 coming from pension, elimination of L3 intangibles, lower interest expense and share count, which was partially offset by a headwind in tax.

Okay. Switching over to guidance for calendar year 2020 on Slide 12, where our ranges account for planned divestitures. Starting with the top line. Organic revenue is expected to be up 5% to 7%, with growth across all segments, which is in line with the growth previously communicated in the S-4 prior to the merger, though on a materially higher base. We do expect the growth rate to start off slower due to the tough first quarter compare. On full year EBIT, we expect total company margins to be between 17% and 17.5%, a 65 basis point improvement over the prior year at the midpoint, driven by higher cost synergies and merger-related accretion. This, combined with a lower share count, results in 2020 EPS guidance in a range of $11.35 to $11.75, up 15% at the midpoint from prior year EPS of $10.08. This guidance reflects about $3 billion in share repurchases, including net proceeds from today's sale announcement, and an effective tax rate of 17%.

We expect to generate between $2.6 billion and $2.7 billion of free cash flow for the year. This implies free cash flow per share of $12 to $12.50 and reflects a 3-day working capital reduction to 64 days or 61 days normalized for purchase accounting with $400 million in capital expenditures.

Now switching to the segment outlook. Integrated Mission Systems revenue is expected to be up 5% to 7%, driven by our incumbent position on Big Safari programs, strong growth in electro-optical and increased share on classified programs in our maritime franchise. Segment operating margin is projected to be between 13% and 13.5%, reflecting increased cost synergies and pension income. In Space and Airborne systems, we expect revenue to be up between 5.5% and 7.5% for the year, driven by technology upgrades, rent production with increased content on long-term platforms and growth in classified space, including small sats.

Segment operating margin is expected to be between 18.5% and 19%, driven by cost synergies, pension income and operational excellence, offsetting growth from lower-margin programs. Communication Systems revenue is expected to be up 6.5% to 8.5%, driven by growth in DoD modernization in tactical and integrated vision systems. Segment operating margin is anticipated to be between 22.5% and 23%, reflecting benefits from operational excellence and integration savings, which more than offset the dilutive margin impact of new program starts.

And finally, in Aviation Systems, we forecast revenue growth of 3.5% to 5.5%, driven by a ramp in defense aviation and moderate growth in commercial aviation. Segment operating margins are expected to be between 13.75% and 14.25% from productivity initiatives across the segment in addition to cost synergies.

Turning to the 2020 EPS bridge on Slide 13. Expected full year EPS of $11.55 at the midpoint reflects a total increase of $1.47 over the prior year with $0.86 from volume, operational improvements and cost synergies, $0.29 from the elimination of L3 intangibles and higher pension income and $0.32 net of interest tax and a lower share count. So to summarize, our outlook reflects continued momentum on the top line and in operational performance.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Doug Harned with Alliance Bernstein.

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

You talked about the improvement in working capital, the 8 days improvement, which is already, seems to me your 6 to 8 day goal for 2022. So I just have to ask, when you look at that 2022 guidance for $3 billion in free cash flow, if you've already met this one and there's more to come, can you walk us through how you're thinking about that now sort of on the -- in the 3 buckets of operational performance, synergies and working capital improvement?

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

So yes, Doug, thanks for the question. I think as you noted, we're making very, very good progress. And we exceeded the goal we set for '19 on free cash flow by more than $100 million and came in 8 days better. Now about 3 days of that is just early collections, and you'll see a little bit of a snapback on that in -- coming into calendar '20. But it's much better than we thought, and I think the team is doing an excellent job in getting that working capital very, very quickly. So '20, we're guiding to $2.6 billion to $2.7 billion. It's an additional 3-day improvement, again, despite some of the additional collections that are snapping back. In '21, we do see the benefit of increasing cost synergies. Some of that's moving left. We'll see an additional 3 to 4 days of working capital improvement. But keep in mind that divestitures do have an impact. They're going to have an impact at the back end of the year, which we have included in our guidance. They're going to impact '21. So on a per share basis, we do see free cash flow per share getting -- continuing to get better. Again, Jay mentioned this year, it's around $12 to $12.50 per share.

As we get into '22, we're still confident hitting the $3 billion target despite the divestitures. You will see another 3 to 4 days of working capital improvement in '22. So again, as we get out to '22, we expect we'll be in the low to mid-50s in terms of working capital performance. We do see maybe some additional cost synergy opportunities sitting out there. And in the low to mid-50s, you remember where we were at Harris, we're at 41 days. So we have another 10, 12 days of improvement beyond that. We're probably still 8, 9 days higher than where the peers are even today. So as I look at it, we still have opportunities to continue to do better in '22. Again, we'll get through '20 -- calendar '20. We'll see where we're at in '21, and then we'll start to shape '22 as we get there.

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

So I guess, the key here is that we should be thinking about this, the $3 billion net of divestitures with still some real work you're going through on portfolio shaping in the meantime. Is that right?

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

That's the way we're looking at it. And I think we're purposeful in saying we're looking at 8% to 10% of our revenue being divested. That is contemplated in achieving a $3 billion free cash flow in '22. So again, we do have opportunities with perhaps additional cost synergies, but most importantly on working capital improvement. And keep in mind, a lot of the opportunities from here out on working capital are going to come from inventory. So we got some of the low-hanging fruit here in calendar '19. We hit it pretty quickly. But getting at sustainable improvements in inventory's going to fundamentally have to improve how we run contracts, how we execute in our factories, advanced payments we get, how we negotiate with customers. All of those things take time, Doug. And that's why we're saying let's get through 2021 and we'll start to feel better about '22.

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*

Bill, or maybe Jay can comment, just on the adjusted EPS bridge you mentioned the range, the midpoint at $0.43 for operations. It's quite a big range from 23% to 63%. Maybe if you could just walk us through any of the puts and takes there that would make you come out at the low end of the high end there.

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

Yes. The biggest piece of that is the volume. So it will move with the volume between 5% and 7%, Peter. I mean, that's the biggest variable. We feel pretty good about our productivity initiatives. And we do have a little bit of headwinds as far as investments, but the biggest variable there is going to be the volume. And to the extent that we get a little bit better or worse, it's going to move it around. So that's the biggest piece, and that's really in the $0.43 at the midpoint.

Operator

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

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

Congrats to the 2 IR professionals. And Anurag, thanks for all the help you gave us over the years.

Anurag Maheshwari - *L3Harris Technologies, Inc. - VP of IR*

Thanks, Noah.

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

Maybe you could give us a sense for how much -- even if a wide range, approximately how much free cash you would be divesting if you divest 8% to 10% of revenue. Just so we can all square up how we were thinking about the free cash trajectory previously versus that.

And then if you could speak to use of proceeds. One, just as a clarification, is there any incremental use of proceeds from the sale of Leidos in the 2020 denominator of earnings per share? And then should we just be thinking about incremental share repurchases every time you're selling something or something else?

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

So first of all, I mean, 8% to 10% of our revenue, and you can run the math of where we ended up in calendar '19, it will be businesses that, in aggregate, will have lower operating margins than the rest of the core company. And so if you just run that math, it will be sub below $150 million worth of free cash impact as we get out to complete the final divestiture. So we've contemplated that in our longer-term guidance. And in our guidance on earnings per share this year, we have anticipated a midyear close on this particular transaction and using the proceeds in the back half of the year for share buyback. And that's contemplated in our guidance as we see it today.

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

So how much share repurchase is in the year then for the guidance?

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

It will be about $3 billion this year from share purchases. We'll do $1 billion in the first half, another $1 billion in the back half through normal share buyback activities. And then as we transact the sale to Leido, we'll get slightly less than $1 billion in net proceeds, and we'll execute on that in the second half of the year.

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

And Bill, further sales, you'll just add to the buyback or something else?

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

Our anticipation today is we'll use proceeds for buyback to offset dilution.

Operator

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

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

Bill, I was wondering if you could comment -- or Chris, maybe, about the book-to-bill that you saw in the last quarter. Obviously, orders can be a bit lumpy. But compared to some of your defense peers, your book-to-bill was a bit softer than what the rest of the industry is seeing.

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

Yes, Rob, thanks for the question. It was a little lighter than we would have wanted for the fourth quarter. And I think you're right, there is some lumpiness. For the calendar year, we did grow our funded backlog by 5%, and we did have a 1.04 book-to-bill. I'm looking at our pipeline that we analyze internally. It is up to $66 billion at this point. So about 10% more than we had last time we talked. So 2020, I think we have some pretty good growth opportunities, a lot of the businesses follow-on and some recompetes, and we're still optimistic that we're going to be able to grow our book-to-bill on our top line revenue.

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

And I think we were pretty careful in our remarks, Rob, that when we talk about book-to-bill on a funded basis, and I think that's a little bit different and perhaps more conservative than what you're hearing from others in the space.

Operator

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

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

Anurag, thank you for all your help. Bill, I guess, when we look at you guys, you're one of the only defense companies out there with a major margin opportunity. On Slide 13, you called out mix as an offset to some operations. Where is the biggest mix impact in 2020? Whether it's in tactical comps, across plus space? And how do you think about these items longer term?

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

So I think the good news of winning a lot last year is -- well, revenue is growing. And you saw that last year and you see that coming through this year. But some of those wins are development programs, new modernization programs. They come at a lower margin and you improve that over time. So the good news here, I think, Sheila, this year coming into '20, is that we continue to execute on the cost synergies. Our E3, our operational excellence program, is really getting some traction. And that is offsetting a lot of the mix headwinds, which is what we expect to see.

And over time, I do expect that we'll continue to grow our margins, both through the drop-through of synergies, continued outperformance on operational excellence despite mix and also perhaps a little accretion coming from the divestitures of some businesses that are likely to go out of the portfolio at less than the overall company margin. So I see it growing over time. And I think, hopefully, we have a good opportunity at the high end of the guidance range here in '20.

Operator

Our next question comes from the line of Carter Copeland with Melius Research.

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

Just I wonder if you might just give us a mark-to-market on the divestiture process and how you're looking at the portfolio, if that's evolving in terms of things that you would consider selling now at this point and just how that process is going. Give us some color on the evolution there.

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

Sure, Carter. This process, we've talked about this even pre close, I think it's going very, very well. It has been a key priority of ours to take a fresh look at the combined portfolio of the company and think through what businesses we want to stay in, which ones are strategic, which ones have technology that could differentiate, where we can generate good returns and really win longer term. And obviously, with the transaction on STS and MacH, our airport security business, we felt that Leidos was a much better strategic owner for that asset than we were. It's a good business, but they're a better owner. So a lot of pre-close planning on this. We got out of the gates very quickly with one. There are several others that are in process or in detailed planning, and we'll announce those transactions as we go through this year and into calendar '21.

So it's going very, very well. We're very pleased with the early results.

Operator

Our next question comes from the line of Matt Sharpe with Morgan Stanley.

Matthew Higgins Sharpe - *Morgan Stanley, Research Division - Equity Analyst*

Bill, you guys have done a pretty good job taking out costs thus far. It looks like you're a fair clip ahead of plan with the $65 million net savings. Where do you see that going at this point in time? Does the original $300 million still hold? And are you seeing incremental opportunity? Or is this simply just an acceleration of the original plan?

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

Well, that's a very good question. So clearly, we're doing better in calendar '19. I think that's a testament to the quality of the integration team we put together, the reviews that Chris and I and Jay have every Monday that started well before we close. In fact, within a couple of days after announcement and have continued since then, I think we're executing very well. As we've talked a little bit about in the past, we're seeing more opportunities on segment and headquarter consolidation. We've gone live on a new benefits plan for all of our employees or all the domestic employees on January 1, went from 44 plans to 4. So quite a good set of activities. And we're finding great volume leverage as we do all of that.

We've had 88 different supply chain events, over $1.02 billion of spend. So we're really moving on this very, very quickly, moving quickly on shared services. So as we move -- and I've talked about in my remarks, the '22 savings target has accelerated into '21, about a year before we -- or faster than we had expected. And we're going to continue to work in that third year in '22. So I would expect that '22 will be better than '21. We're not going to size that as we sit here today, but I think you'd expect that the team is going to continue to look for integration opportunities.

Operator

Our next question comes from the line of Myles Walton with UBS.

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

I was wondering if I could go back to the margins for a second for 2020 and the implied range of 17% to 17.5%. Is pension, 30 or 40 basis points, help to that range? And if so, why is it not a higher range, given you're already doing 17.3% in the back half of 2019?

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

Okay. So -- right. If you kind of normalize on the full year, Myles, it's about 40 basis points improvement on pension synergies at 115. Incremental year-over-year is almost -- it's about 60 basis points. We do have some -- basically a placeholder to midpoint there. For incremental investment and mix, as Bill just mentioned, it's about 50-50 between those 2. Our objective there is to drive the productivity higher to really offset fully the impact of the mix and get us really towards the high end of that placeholder of 17.3%, closer to the 17.5%.

So you just have to normalize kind of the full year 2019 to about 70% on a kind of apples-to-apples basis with the full year impact of the pension and intangibles.

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

Okay. And one follow-up, Bill, if I could. The $700 million bogey you talked about for R&D, what's the new kind of run rate? Or is it the same run rate, just at a higher sales pace?

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

Yes. It will be in the same range. I mean, again, we believe that spending around 3.8%, 3.9%, 4% of our revenue is about where we ought to be, but it's not so much a specific number or the percent, I don't see that changing much over the next couple of years, is making sure that we fund the great ideas and opportunities that are coming at us. And that's looking hard at what we're spending our money on today. And if we have new ideas like that are coming through in revenue synergies, large -- most of them do require some level of investment. We want to make sure we put our R&D dollars on those projects that have the best return. And that may mean reducing some others or adding to the top line in total. But right now, we think in that 3.8%, 4% range is probably a good number to use.

Operator

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

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

Can you talk about the nonmilitary business in commission, if you will? I think you talked about the guidance that promotion model is a bit in aviation. But bigger picture, where are things going with FAA simulating the associated MAX? And then how does your exposure to this machines should be divestitured?

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

So it broke up a little bit there, John, but I think it was around DoD and non-DoD businesses. So any comment on that, if I don't hit the mark, maybe you can follow up. But as we look at how we did in 2019 at about 10% growth, we saw the DoD businesses of the company, which are about 60% of our revenue grow mid-teens. That's a little bit higher than what the outlays were last year. And what -- and the rest of that, which is non-DoD U.S. government, commercial, international, growing in the sort of low mid single-digit range. And on an aggregate basis, it was around 10%. As we come into this year, we see the DoD businesses again growing pretty well higher than outlays. So we expect in a high single-digit range with the sort of the non-DoD businesses plus international in the low to mid single-digit range again and, again, on a combined basis, in that 5% to 7% range. So I don't know if I answered the question specifically, but maybe you can clarify it.

Operator

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

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

Wanted to ask about synergies. So it looks like, in Q4, you did $50 million net on run rate. But in 2020, you're forecasting $180 million, which would imply a lower net run rate. Do I have that correct?

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

Yes, David. That's -- your math is right. As we go into '20, we do start to see a couple of areas where we see some negative synergies, including sort of equalizing, harmonizing our 401(k) plan would be one of the items that happened to be in there. So your math is correct.

Operator

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

Jeffrey Joseph Molinari - *Cowen and Company, LLC, Research Division - Research Associate*

This is Jeff Molinari on for Gautam. So Bill, I'd like to circle back to the bookings outlook. Do you expect book-to-bill to be above 1x in this year? And can you give any color by segment which could be the strongest, weakest? Or any large international opportunities to call out?

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

So maybe I'll start on that, and Chris can jump in here. Yes, we ended the year, as you mentioned, just over 1 this past year. The backlog was up 5% on a funded basis. That was sort of a good progress on a 10% revenue growth year. As we get into next year, we do anticipate book-to-bill being somewhat above 1, it should be above 1 across the segments. We have -- it's a little bit early in the year to kind of call the ball on that. It's hard to predict when orders happen, but, yes, we do expect a north of 1 book-to-bill. We do see international to have some growth outlook for us. It means we believe '20 would have a little bit more runway. It will start to accelerate maybe in '21 and '22 because we've got a lot of opportunities on the international market. So we do see bookings to be pretty healthy through the course of calendar '20 if the market holds as we expect it would. We don't really give sort of guidance at that level down to the segments, but I think you'll see across all the segments some healthy trends, good pipeline. Chris mentioned a $66 billion pipeline across the company. And it's pretty robust across the franchise. As I just look at our Space and Airborne Systems business, that business or pipeline was up about 10% over the 6 months from close to the end of the year. So the opportunities are coming quickly. Our B&P activity is very, very high. So we think the outlook's going to be pretty good over the course of calendar '20 on both bookings and revenue.

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

Yes. I'll just chime in and say, as we look forward to 2020, we'll clearly target well over a 1.0 book-to-bill. If you look at IMS and some of the opportunities, I mentioned the Peregrine program for ISR. Clearly, there's a couple of other international countries that are interested in a derivative of that capability. So I think that's going to give us some international opportunities. We look across the globe, we see most of the opportunities, as we've talked about before, in the Asia Pacific region and the Mid East. And I think some of those countries and opportunities have been pretty well publicized. Electro-optical, that's a 50-50 business between domestic and international as an example. A lot of the work we're doing in EW and the TR3 program for the F-35, F-18, F-16, those both have domestic and international opportunities as well, including tactical radios. And I mentioned in my prepared remarks even Mission Networks with the work in India is going quite well. And there's another country or 2 that are interested in that capability. So good pipeline, a lot of follow-on, a lot of opportunities, and we'll keep you updated as we make progress throughout the year.

Operator

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

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

Bill, I wonder if you could talk a little bit about so tactical radios in 2020, both in terms of the more, I guess, qualitative milestones and in terms of the progress towards that $1 billion-plus out your goal that you expect this year.

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

Yes, Seth. So thanks for the question. And we had a very strong calendar '19. We're very pleased with the team's performance. So tactical radio as a whole grew in the mid-teens. It was pretty much equal weighted in the back half, in the front half. DoD was very, very strong, sort of in the mid-30s, which was very good and much better than we had thought as we started 2019 and progressed through the year. So it kept getting a little bit better. International, low single digits, which is basically what we thought -- where we thought we would be. And as you saw in the attachment on the back of our webcast, the tactical backlog sequentially is up about $50 million, down a little year-over-year, but it's pretty healthy at about $1.1 billion. So the trends here are very, very good. In calendar '20, we see growth rate moderating a little bit. We see overall tactical in the mid- to high single-digit range, DoD around 10% off a very, very strong year in calendar '19. Modernization is ramping quickly. It doubled in the back half of '19. We see growing substantially again in calendar '20. As we look at calendar '20, modernization revenue will be something like 2/3 of the overall DoD business. So it's growing very, very quickly. The offset is a little bit of reduction in the base and readiness spend. As we always anticipated and explained, that's going to shift the modernization over time. We do see that happening here in calendar '20. It's possible that our guidance is a little bit on the conservative side, as we've seen in the last couple of years. We know we're on the front end of a very, very strong ramp in modernization.

As we look at this, there's only been about 25,000 modernized radios that have been ordered so far of what we expect to be about 150,000 over the 5-year period and maybe 300,000 to 500,000 radios over time. So we're at the front end of the ramp of modernization. The funding looks very, very good when all programs, all service is performing well. So I think the DoD side looks good, and we continue to see a $1 billion business sitting out in '22.

Operator

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

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

Bill, I wanted to ask you a high-level question. What do you think is maybe the most misunderstood aspect of the story or at least the least well appreciated?

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

Well, I think we're relatively new here, Rob. At the end of the day, where -- you are in existence for 7 months. So we had 2 very strong companies that came together. And I think what you're seeing through the results we reported in Q3, Q4, now guiding for the year, you're not seeing hiccups or bumps in this colossal MOE. It's executing very well. The integration savings are coming through. The working capital performance is coming through better than we expected. We're tightly managing capital. We're improving our B&P performance. We're executing at the customer interface. The team is excited and energized. At the end of the day, I think investors will see that more and more over the course of '20 in our results. I think the early results are quite good, and you'll see that coming through the balance of the year.

So I don't know if that's understood or misunderstood by investors, but I think that's, to me, is what should be coming through clearly in both the results we're reporting, which is what's meaningful to investors, but also the guidance we're providing today.

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

Okay. Do you think people are just so focused on that out-year number that you've put out that it's limiting their view of the fars, so to speak, from the trees?

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

Look, I think we've been pretty transparent about setting goals out a couple of years as to what we're trying to achieve internally. We don't set those goals without a road map to get there. We're just not going to overreach. At the end of the day, we know we can add $3 billion in '22. We've talked about portfolio shaping. We're out of the gates very, very quickly on that. Those things do take some time. It has to be a buyer and a seller, as you all know. So we've got to make sure we conclude those transactions. We got to make sure we get really good trajectory here on the working capital performance. Again, I feel great about the fact that we're down 8 days, a little bit more of that with purchase accounting. We've got a great opportunity to continue to perform on that. And as we keep executing every quarter and keep demonstrating results and get closer and closer to that goal, and perhaps that goal goes up over time, I think the story is going to be much better appreciated. I think the one area where I think it should be important to investors is the growth opportunity that we see longer term in international markets. Chris talked about this. We're not where our peers happen to be. We have lots of opportunities. We put focused effort on that. So Rob, I think we're on a great -- we have a great start here. We're performing very, very well. And I think we're all collectively optimistic about the future. .

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

Best wishes on rock.

Operator

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

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

Bill or Chris, could you guys talk about your unmanned surface vehicle strategy? I know you've kind of got some exposure there today, especially in the restricted world. And obviously, the Navy is looking at things. I don't know if you can size it for us and maybe talk about how big it could be.

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

Yes. Thanks, Pete. It's Chris. I'll step back and start talking maybe a little bit more about autonomy in general. We think we're well aligned with the national defense strategy as they're taking the capabilities away from these major programs and disaggregating them. So the need for autonomous vehicles is growing. So we have capabilities, as you know, with unmanned air vehicles, unmanned undersea and unmanned surface vehicles as well.

In fact, later this week, Bill and I are going to be reviewing a bid for an unmanned surface vehicle. We've been pretty successful so far. There's the medium unmanned surface vehicle. There's a large unmanned surface vehicle. They come in different shapes, different flavors. In some cases, we are subbing a subcontract to a prime. And in other cases, we're priming. These are several hundred million dollar opportunities over a couple of years. And I think the systems and the capability we bring put us in a unique position, and it aligns with what our customers are talking about. You hear about multi-domain ops, distributed maritime, ABMS. This is all about connectivity. And this is in our sweet spot, and I think something that can provide growth over the long term.

Operator

Our next question comes from the line of Michael Ciarmoli with SunTrust Robinson Humphrey.

Michael Frank Ciarmoli - *SunTrust Robinson Humphrey, Inc., Research Division - Research Analyst*

Maybe, Bill or Chris, I mean, you guys hinted at it a couple of times running about a year ahead of plan. We are looking at that -- obviously, that $3 billion 2022 free cash flow target. And keeping in mind, I guess, you said maybe $150 million comes out from divestitures. What -- if everything else is running ahead of plan, should we think that, that maybe that $3 billion has some potential upside to it? Should we think about achieving that goal coming in ahead of plan? And again, realizing that you've kind of laid out where working capital can go, but just trying to reconcile the 2 there.

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

Look, I mean, we -- it's hard to be more clear about what we're trying to do. We're not going to take the goal up in '22 today, but there's a couple of dimensions that go to that. One is the opportunity to overdry '22 versus '21 on cost synergies that we're really focused on. We've got to keep the top line growth momentum going, and revenue synergies in '22 should contribute to that. And we are really moving fast on working capital performance and the detailed analysis that's happening here at a very discrete level across the places in our company that have the highest amount of working capital, highest inventory, the longest number of days. We're putting a lot of time and effort into that. And if we can move that along faster, all of those things will contribute to doing better than $3 billion in '22.

Today, we're focused on executing Q1 of '20 and then calendar '20 and then making sure '21 goes really well. And it's a whole lot of heavy lifting on the integration of working capital, on top line growth. There's a lot of pieces that are going on here. So as we go through the year, and to get a better sense of how we're progressing on all these dimensions, we'll continue to shape for investors what our expectations are going to be in 2, 3 years out. But today, we feel good even despite the divestitures of getting the $3 billion in '22.

Michael Frank Ciarmoli - *SunTrust Robinson Humphrey, Inc., Research Division - Research Analyst*

That's helpful. And maybe just a quick follow-up on that. You haven't talked about footprint as it relates to maybe some of the working capital or other savings. Can you give us an update on where we are? I think, at one point, maybe it was 400 combined locations. Where are we now?

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

That's true. I mean, we have -- we have about a little over 400 locations, 28 million square feet. As we sized the original aggregating at the $500 million of cost savings, we said that would be coming down in the 8% to 10% range. We have a number of projects that are underway, some have been announced and have not been. Those things do take some time. There's been some early wins in the first part of the integration period, office spaces where it's easy to vacate. When you're thinking about moving production or engineering development sites, they take more thoughtful planning and making sure that we do them well. They take some time. So you'll see -- and typically, you'll see a 2.5, 3-year payback on those kinds of initiatives. And I think it's very typical when you're moving facilities. So we'll see that more in the back end of the integration period as opposed to the front end.

Operator

Our next question comes from the line of Richard Safran with Buckingham Research.

Richard Tobie Safran - *The Buckingham Research Group Incorporated - Director of Equity Research*

Rajeev, welcome. Anurag, it's been a real pleasure. I had a question this morning on something I've asked about before, contract mix. Based on the opportunity set you're pursuing, and then always to the best you can, could you just discuss how you see your contract mix trending in '20? As always, I'm just curious to see if you're moving towards or away from more fixed price or commercial contracts. And by the way, just separately, if you could discuss how you see overall classified versus unclassified growth trending long term. Just curious to see how you think those 2 play against each other.

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

Great, Richard, it's Chris. And if Jay wants to add anything at the end, I'll allow him to do so. I'll take it in reverse order. I mean, classified right now is about 20% of our portfolio. We grew double digits in '19 over '18, and we see some really good opportunities across all of our segments when it comes to classified work. So unfortunately, there's not a lot of detail we can give you in that regard. But we're very, very upbeat in the classified arena, both as a prime and both as supporting some of the other industry partners. Relative to the contract mix, we're seeing it pretty stable on the mix over the next year or so. And I'll let Jay give you to the specific numbers, but when you run a portfolio, we talk about these new opportunities. We didn't talk a lot about revenue synergies. But Bill mentioned the 5 wins. A lot of those start out as kind of cost plus developmental programs. We move into LRIP, we move into production, then sometimes we export internationally. So you just -- a healthy portfolio over time, you want to have those cost plus and developmental programs feeding the pipeline. You also want to have the mature fixed price and then you want to be able to export. So if you put that all together, we're going to be in the same range. I don't know, Jay, you want to give a little more specific?

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

Yes. I mean, the fixed price, the mix is about 70% fixed price, 30% cost plus. And as you would expect, that requires a rigorous approach to visit proposals. And that's what we have, pretty solid processes in place, to make sure that we're managing the risk appropriately. But it's not new. We've been at 70% for some time here. We don't expect that to change substantially from where we are today.

Operator

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

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

Yes. The margin in the quarter of 17.3%, I mean, the implied guide based on your second half guidance was 16.8%. So is the improvement due to quicker synergies, as you mentioned, or lower investment? Or if you could just clarify that a little bit.

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

Sure, George. It was a combination of 2 things. One was synergy. Synergists were better than what we guided. And also, we had a little bit of a benefit from pension as well. And so that dropped through. Really, the combination of those things dropped through, both of them, to get us to the '17 through.

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

And then just one clarification. Jay, you mentioned in the release that the guidance includes the divestitures. So I assume that includes the divestiture of the airport business. How did you then calculate aviation sales? You took out $250 million for half a year in each year. Or if you just explain what went on there.

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

Yes. So first of all, yes, it does include that divestiture. We guided the revenues organically. And so the AS guide is organic number as well as the overall 5% to 7%.

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

Okay. So you took out the sales from the prior year as well to get the organic number?

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

Right.

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

Okay. Thanks a lot, Anurag, for your help, and welcome, Rajeev.

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

So thank you all for joining us today. We're off to a terrific start as a new company. I think we're well positioned for continued success in 2020 and beyond. Our employees and our leadership team have remained focused on meeting customer expectations, executing with precision and delivering value to shareholders. And I'm real proud of them, and I want to thank them for their hard work and for their dedication. Thank you again, everyone, for joining our call 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.
