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LHX.N - Q2 2024 L3Harris Technologies Inc Earnings Call

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## OVERVIEW:

Company Summary

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**Christopher Kubasik** *L3Harris Technologies Inc - Chairman of the Board, Chief Executive Officer*

**Kenneth Bedingfield** *L3Harris Technologies Inc - Chief Financial Officer, Senior Vice President*

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**Seth Seifman** *J.P. Morgan Securities LLC - Analyst*

**Robert Stallard** *Vertical Research Partners - Analyst*

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**Kristine Liwag** *Morgan Stanley - Analyst*

**Myles Walton** *Wolfe Research, LLC - Analyst*

**David Strauss** *Barclays Bank PLC - Analyst*

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## PRESENTATION

### Operator

Greetings. Welcome to the L3Harris Technologies' second quarter 2024 earnings conference call. (Operator Instructions) As a reminder, this call is being recorded. It is now my pleasure to introduce your host, Dan gets Divisional Vice President, Investor Relations. Thank you, Dan, you may now begin.

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**Dan Gittsovich** - *L3Harris Technologies Inc - Vice President, Investor Relations*

Thank you, Rob. Good morning and welcome to our second quarter 2024 earnings call. Joining me this morning are Chris Kubasik, our CEO; and Ken Bedingfield, our CFO.

Yesterday, we published our second quarter earnings release detailing our financial results and guidance. We have also provided a supplemental earnings presentation on our website. Today's discussion will include certain matters that constitute forward-looking statements. These statements involve risks, assumptions, and uncertainties that could cause actual results to differ materially. For more information, please reference our earnings release and SEC filings.

We will also discuss non-GAAP financial measures, which are reconciled to GAAP measures in the earnings release. For those of you, I haven't met yet, I'm new in this role and look forward to engaging with you in the near future. I'd now like to turn it over to Chris for some remarks.

**Christopher Kubasik** - *L3Harris Technologies Inc - Chairman of the Board, Chief Executive Officer*

Thanks, Dan, and welcome to the IR team and your first earnings call with us. Last month marked the five year anniversary of the transformative merger between L3 and Harris and the creation of the industry's trusted disruptor, a proven alternative to both traditional primes and new entrants, focused on relentless innovation to deliver capability with the speed, passion, and determination that our customers demand in executing their most challenging missions.

Unlike traditional primes and new commercial entrants, we utilize both commercial and government business models with significant presence in each. We deliver commercial short-cycle products, such as software-defined radios.

We also execute on critical long-term programs that span the entire lifecycle, from development to production, including international exports and ultimately, sustainment, and support. Our diverse and platform-agnostic portfolio enables us to work across the ecosystem as a prime, a sub, or a merchant supplier to deliver the best solutions for our customers and the best returns for our shareholders.

Further as a trusted disruptor, we are actively looking for opportunities to partner with small and large companies where it makes business sense. It was one year ago that we announced the successful addition of Aerojet Rocketdyne to the L3Harris portfolio.

This acquisition increases our content on missile platforms and positions us for growth in new markets. A recent example is our role on the Missile Defense Agency's next-generation interceptor program. This leverages our industry-leading propulsion technology and innovative attitude control systems to defend against long-range ballistic missile threats. We are also integrating legacy L3Harris electronics capabilities.

Since closing the acquisition and as we've discussed on our last two earnings calls, we've made substantial progress in improving the operational performance of the business, and we continue to make investments to increase capacity and drive efficiencies to meet our customers' growing demand, including the expansion of key facilities in Arkansas, Alabama, and Virginia. As a result of these combined efforts, we have reduced overdue deliveries by nearly 40% in the past 12 months.

Several of you had a chance to visit our Inert Center of Excellence in Huntsville, Alabama. And we know you left with a better understanding of the business and the progress to date. Since the merger, we focused on integrating and shaping the portfolio to align with national security priorities and the future of warfare. We're in the right businesses spanning all domains, while earning the highest margins in the industry with further upside potential.

Looking forward, we remain committed to meeting the expectations of our customers and creating additional value for shareholders. And our second quarter reflects progress towards achieving these commitments.

We reported strong financial results for the second quarter, highlighted by segment operating margin of 15.6%, up 80 basis points versus the prior year, and non-GAAP earnings per share of \$3.24, up 9%. These results underscore our focus on execution and driving profitable growth. On the demand side, our pipeline of domestic and international opportunities remains robust and our total backlog stands at \$32 billion.

In our communications systems segment, we ended the quarter with record backlog of over \$6 billion from increasing demand for our resilient communication products. This is driven by DoD and international customers' needs for seamless, resilient communications across multiple domains as they face increasingly sophisticated near-peer threats.

We continue to work with these customers to help them avoid the inherent vulnerability that comes from relying upon commercial communication in satellite network providers for their critical mission.

Our tactical communications business continues to see growing international demand for European and NATO allies totaling more than \$1 billion in the near term opportunities and a continued robust pipeline of greater than \$10 billion. Overall, we are continuing to see plenty of opportunity for resilient communications, propulsion, and ISR to highlight a few of our capabilities.

We continue to make strides in our operational performance, which is reflected in our expanding margins. Programmatically, we're beginning to realize the benefits of our maturing risk management processes and disciplined bid rigor as well as the initial benefits of our LHS NeXt program and that is showing up in our program results.

Our first half performance provides confidence for the remainder of the year, leading us to increase our guidance, which Ken will discuss in more detail. I'm pleased with the progress we're making on our LHS NeXt initiative. In the second quarter, our efforts focused on workforce and infrastructure optimization, including a strategic collaboration for managed services designed to accelerate the modernization and automation of our IT infrastructure, while reducing cost and transforming how we operate as a business.

We made great progress and we're ahead of schedule. The next phase of LHX NeXt is centered around the supply chain management and leveraging the scale of our enterprise. This will improve cost quality and delivery for our customers, while simultaneously offering our suppliers' demand stability and an opportunity to grow along with us. And for us, it means supply chain management will be a competitive discriminator.

Turning to capital deployment, as promised we are prioritizing debt paydown, continuing to maintain a competitive dividend and returning excess capital to shareholders. In the quarter, we returned over \$300 million to shareholders through dividends and share repurchases and remain on track to meet our stated 2024 target of approximately \$500 million in share repurchases, holding outstanding shares flat year over year.

Aligned with our national security focus, we recently completed the sale of our antennas business and expect to finalize the pending divestiture of our commercial aviation business later this year as we satisfy the remaining conditions to close.

And finally, I want to thank the four Board members who served on our Ad Hoc Business Review Committee. Their recommendations were presented to the Board last week, and we are implementing actions in accordance with those recommendations.

The focus was on reviewing our strategy and portfolio, program management, disciplined bidding processes, and LHX NeXt plans. The Business Review Committee executed as per its charter and as such is now dissolved. These recommendations are appreciated and as I noted, are being executed in a rapid manner to continue to drive value for our shareholders and customers. I'll now turn it over to Ken to provide insight on our second quarter results and 2024 guidance.

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**Kenneth Bedingfield** - L3Harris Technologies Inc - Chief Financial Officer, Senior Vice President

Thanks, Chris. I'll start with consolidated results for the quarter. Demand remains high. And in the second quarter, we were awarded over \$5 billion in new awards, resulting in a book-to-bill of 1.0 and total backlog of \$32 billion.

We were awarded a nearly \$900 million contract for the delivery of electronic time fuses, which play a crucial role in replenishing our nation's critical ammunitions inventory. We were also awarded a \$1 billion IDIQ contract with an initial task order of \$123 million to supply the next lot of multifunctional information distribution systems, jitters terminals to the US Navy, leveraging the unique capabilities of the TDL product line that we acquired last year.

Consolidated revenue grew 13% or 1% organically. Operating margins continued to be strong, expanding to 15.6%, up 80 basis points, reflecting improved operational and program performance across all segments with LHX NeXt cost savings contributing.

Chris highlighted our EPS growth of 9% as a result of strong operational performance. I'd like to add that on a pension adjusted basis, second quarter EPS was up 13% as profitable growth drops to the bottom line.

Free cash flow was \$714 million for the second quarter, driven by increased operating income and improved working capital performance. In the quarter, we repaid a \$350 million note, which helped reduce our net leverage to 3.2 times, down from 3.5 times in the previous quarter.

By segment, organic growth within our communications systems segment was over 4% from higher production rates and deliveries of resilient communication products. Space and airborne systems segment revenue was flat with growth in space systems and classified programs, offset by lower volumes in our airborne combat systems business as we focus on negotiating appropriate business terms.

Integrated mission systems revenue was also flat as higher volumes on maritime programs were offset by lower volume in our commercial aviation business. Aerojet Rocketdyne contributed to almost \$600 million of revenue for the second quarter.

Turning to margins. CS reported margins of 24.4%, down slightly year over year, reflecting the timing of software sales and higher DoD revenue mix, which is first half-weighted as we've previously discussed. This was partially offset by LHX NeXt cost savings and the favorable net one-time impact of legal settlements.

We continue to expect higher international mix and margin opportunity in the second half. In SAS, margin expanded 280 basis points to 12.6% as we continue to see progress on development programs maturing to production and realize the benefits of our LHX NeXt initiatives.

IMS continues to make progress on program performance and LHX NeXt, resulting in a margin of 11.9%, a 260 basis point increase versus the prior year. Consistent with the plan to rationalize our footprint outlined at Investor Day, we completed the consolidation of three facilities in the segment in the second quarter. Aerojet Rocketdyne reported margins of 12.9%, which included \$22 million of amortization of purchase accounting adjustments.

With the acquisition now one year behind us, we are wrapping up the purchase accounting period. With respect to the purchase accounting fair value adjustments for loss provisions and off market contracts, I'll point out these reflect adjustments to baseline contract performance as of the date of acquisition and are not impacted by our subsequent operational improvements, which we expect to see continuing improvement from in our future margin profile.

Simply, the adjustments reflect a more informed assessment of the state of legacy contracts as of the date of acquisition close.

Finally, turning to guidance. Given our strong first half performance, we are increasing guidance for revenue, margin rate, and EPS, which we've outlined in our earnings release and presentation. We now expect EPS in the range of \$12.85 per share to \$13.15 per share. And we are reiterating free cash flow guidance of \$2.2 billion.

The increased guide for revenue, margin, and EPS incorporates solid growth and operational performance in the first half of the year and a few more months of additional revenue from our commercial aviation business with the pending divestiture now expected to close in the second half.

We're pleased with our performance through the first half of the year, highlighted by a year-to-date book-to-bill of 1.03, organic revenue growth of 3%, and sequentially increasing segment operating margin, and we remain confident in delivering on our commitments to customers and shareholders. Rob, let's open the line for question.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) Peter Arment, Baird.

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**Peter Arment** - *Robert W. Baird & Co. Incorporated - Analyst*

Yeah, good morning, Chris, Ken, and Dan, nice results. Ken, maybe just to ask on Aerojet and the margin performance in the first half continues to be really strong, but then you compare it to where the guide is for high 11% implies margin step down. Maybe if you could just walk through that or just the thinking there, or is it just conservative or is there other things that maybe you just mentioned that we should understand? Thanks.

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**Kenneth Bedingfield** - *L3Harris Technologies Inc - Chief Financial Officer, Senior Vice President*

Sure, Peter, appreciate the question. With respect to Aerojet, I would say, look, the business is performing well, halfway through the year. We're happy about the margin performance there certainly some aspects of mix in terms of which programs are seeing the volumes at which point through the year as well as you know, as we performed in the first half we were able to see some positive program performance that we've got to go do again in the second half of the year.

So, you know, we feel good about how Aerojet Rocketdyne is performing. And it's been about a year since we've integrated this business and we're continuing to learn more. I think you saw that the purchase accounting period ended as well.

So we've got that kind of information behind us, better informed with the improvements that we're making and how we're driving operational improvements in the business. And we'll work to continue to deliver on that in the second half and see if we can replicate what we did in the first half of the year.

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**Operator**

Seth Seifman, JPMorgan.

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**Seth Seifman** - *J.P. Morgan Securities LLC - Analyst*

Thanks very much and good morning. Wanted to ask, I guess, Ken and maybe Chris as well when you gave the outlook and the targets at Investor Day, it was, I think, about 100 basis points of margin improvement in each business now that we've seen starting off pretty well here through the first half of '24. As you look out, if there are any refinements you might make in terms of how you see getting to that 16% margin and the contributions from the various businesses, given how they've performed so far and what you've been able to on I'll get out of the LHX NeXt program.

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**Kenneth Bedingfield** - *L3Harris Technologies Inc - Chief Financial Officer, Senior Vice President*

Yeah, thanks. I appreciate it. I would say, as we look back at Investor Day and the midterm financial framework that we set out, growing to \$23 billion in revenue in '26, 16% margins, and \$2.8 billion of free cash flow in that period, I think where we are today gives us more confidence in delivering to that framework.

And if you think about the businesses, they have been performing well, I think we've got the programs performing. The work we're doing around program excellence is paying off. I think that if you look at our guide across the segments, where we've picked up SAS margin a bit, the same with IMS and CS as well.

So -- and then if you look at the business, first half of the year, we're at 15.3% growing from I think it was 14.8% last year. We're making solid progress towards that 16%. I would say that we feel better about it and we are trying to reflect that in the guidance updates that we're making, again, pickups across three segments and then picking up margin from where we were kicking off 2024 at about 15% to pick it up to a range of 15.2% to 15.4%.

So really making good progress towards that framework. I think we're building confidence on a quarter by quarter and as we progress through the year and then get into '25, we'll try to provide better clarity around our progress on that. And, you know, again, building confidence and maybe it's something that we'll see some acceleration.

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**Operator**

Robert Stallard, Vertical Research Partners.

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**Robert Stallard** - *Vertical Research Partners - Analyst*

Thanks so much. Good morning. Chris, you highlighted that your margins are some of the best in the defense industry, but at least based on to your second quarter numbers, your bookings and your revenue growth are a bit behind some of your peers. I was wondering if that reflects this discipline that you've had with regard to bidding terms and contracts in that, or is it just this is not fair comparison just for this quarter?

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**Christopher Kubasik** - *L3Harris Technologies Inc - Chairman of the Board, Chief Executive Officer*

Yeah, Rob, it's tough to look at one quarter for a bookings or book-to-bill ratio. For year to date, we're feeling pretty good as to what we've been able to book out at a great first quarter. So one quarter doesn't make a year. I think our portfolio is well-positioned and we're continuing to be disciplined in what we bid. And I think you're seeing that in the results, especially on the margin front, some of the prior strategic decisions we made to invest and go after prime positions with SDA for satellites, maybe changing our waveform strategy, what we're doing with counter-UAS with VAMPIRE, winning Armed Overwatch.

All those programs are starting to pay off and as Ken mentioned, we've really upped our program management and execution with training, new tools, hiring experienced hires externally where appropriate. And we talk about bidding discipline that's making sure we have the right contract type.

I think we were one of the first to come out and say we are not going to bid fixed price development programs with options at the proposal process. And we're doing a lot better getting the cost basis and asking for a reasonable fee. So we're taking our time and we're negotiating and I would expect the third quarter, we'll see a bump relative to the book-to-bill.

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**Operator**

Ron Epstein, Bank of America.

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**Ron Epstein** - *BofA Global Research - Analyst*

Hey, good morning, guys. Chris, maybe a big picture question. We just had the NATO Summit and the Royal International Air Tattoo about a week ago, Farnborough. It really does seem like spending in Europe is on the rise, reaching that reflected in some of the defense equities in Europe. What opportunities does that create for L3Harris and maybe new markets or things that the European industrial base just can't do themselves. Can you talk about that a bit?

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**Christopher Kubasik** - *L3Harris Technologies Inc - Chairman of the Board, Chief Executive Officer*

Absolutely. I actually was in attendance at the Defense Summit as part of the NATO Summit in DC with the various ministers of defense and international customer, leadership. And it was a different tone than in the past, and I think you're hitting on an excellent point, I think most US companies don't view Europe as a growth market or even much of a market because of the indigenous capabilities that exist.

But the theme at the NATO Summit was all about the interoperability and the need for these countries to either bundle acquisitions or have their products work. And with the conflict in Ukraine, I think everybody sees the benefit of the interoperability, not only amongst the 32 member countries, which includes the US, but given the threat profile in Europe.

So in our case, we look at our software defined radios as a perfect example. I think we're uniquely positioned there and there was a lot of interest in that. Back of the envelope. We think this could be 100,000 radio opportunity in the years ahead. So Europe is one of our larger markets that we're now going after for all the reasons you mentioned, Ron. And I think that's a nice upside for 2024 and should give us some tailwind in the years ahead.

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**Operator**

Kristine Liwag, Morgan Stanley.

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**Kristine Liwag** - *Morgan Stanley - Analyst*

Hey, good morning, Chris, Ken, and Dan. So maybe I'm wrapping up on the Ad Hoc Business Review Committee. You mentioned that it completed its review. So can you provide any color to the extent of recommendations it made and some of the findings? What is now the implementation plan? And how is this different from the multiyear outlook you've given at the Investor Day?

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**Christopher Kubasik** - *L3Harris Technologies Inc - Chairman of the Board, Chief Executive Officer*

Yeah, thanks for that question, Kristine. I'll just say I thought it was a good review. We all learned from the process and I'd say all parties, both the members of the Ad Hoc business review committee and management have benefited from the discussion and it has no change on our 2026 financial framework. And the ideas, suggestions, and discussions were beneficial, and we're already implementing some recommendations, and we'll continue to do so throughout the year.

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**Operator**

Myles Walton, Wolfe Research.

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**Myles Walton** - *Wolfe Research, LLC - Analyst*

Thanks. Good morning. I was hoping to maybe if you could Chris drill into the communications systems order trends, and backlog as you see it sitting here today in the first six months. And also from an international perspective, I think it was about flattish growth in the first half and DoD was more driving it. You're expecting, I think that to shift in the second half. Just curious if the order trends are starting to accelerate on that front.

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**Christopher Kubasik** - *L3Harris Technologies Inc - Chairman of the Board, Chief Executive Officer*

Yeah, thanks, Myles. As I said, we have about \$32 billion in backlog way up from when the company was formed five years ago, I guess in CS. I really see three major areas. The DoD modernization we've been talking about for quite some time. And if you go back, there was a basis of issue what we call BOI to buy 480,000 radios from us and our competitors.

To date, we've delivered 180,000. So there's still a 300,000 radio opportunity. And clearly, as these IDIQs have annual task orders, we've been rather successful in winning our fair share or more than our fair share. And I expect that to continue.

During the pandemic, we actually invested in capacity up in Rochester. We've come up with some new techniques. We have what we call our smart cell, which is a different way of integrating radios. We've seen our yields improve, we're using a smaller footprint, and it's really a change in the way that we integrate our radios.



We continue to invest in software, we have some new waveforms. And I think it's important to remember, these are software-defined radios. So the hardware probably has a 10 to 15 year life. So there'll be a replenishment of that.

But more importantly, there's a continuous demand for the software and the upgrade. So the DoD modernization as far as we can see, continues to look good. The budgets will come out and they'll adjust the quantities based on that.

But there's clear demand here in the US. I mentioned the NATO in an earlier question, again, we see a huge opportunity for NATO with that focus on interoperability. And we continue to have success around the globe with our software-defined radios and the whole focus on resilient comms. I think that's one of the lessons learned. There is a big difference between just being able to communicate and communicate in a resilient protected fashion in our networks.

Our coming out is world class and in that regard and I've alluded to our software and waveforms, we are continuing to see demand for our resilient waveforms. And this is one of two markets, it's either an upsell for new software-defined radio or it's a licensing opportunity for the installed base.

So just on CS, we have about a \$16 billion pipeline looking out three years as I mentioned \$10 billion international, the rest domestic, so feel real good about the business and the growth potential. And just to close off, we don't see any supply chain issues or constraints as we have in the prior years, which gives us even further confidence in the outlook.

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#### **Operator**

David Strauss, Barclays.

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#### **David Strauss - Barclays Bank PLC - Analyst**

Thanks. Good morning, everyone. When does the -- Chris, Ken if you could maybe dig into the IMS margins a little bit. We've seen nice improvement here in the first half, but it looks like you're forecasting kind of flat to maybe down a little bit sequentially off Q2 in the second half.

From what I remember from the Investor Day, the commentary was around that you would move through some of these fixed price development programs in the second half of the year. And if anything, we would start to see the margin improvement in the second half of the year. So if you could just maybe address IMS margins. Thanks.

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#### **Kenneth Bedingfield - L3Harris Technologies Inc - Chief Financial Officer, Senior Vice President**

Sure. Thanks, David, appreciate it. From an IMS perspective, I would say a couple of things. One, we're really happy to see the performance that IMS has had in the first half of the year. I think the programs are performing well and that's delivering solid margins for us and significant growth over the first half of '23.

In terms of the margin profile between first half and second half, a couple of things. One, we did have some favorable commercial mix in the first half in terms of electro-optical more kind of commercial type of business within IMS. And then we are starting to see the benefits of LHX NeXt cost savings. Those should endure as well.

But from a first half second half perspective, I think it's two things. One, just the mix commercial, we are going to see growth in IMS in the second half. And we talked a little bit about the first half with the IMS having a little bit of growth headwinds with respect to ISR and some aircraft procurements in the first half of '23.

As that abates, we may see some mix that moves a little bit more towards ISR, some of the businesses that aren't as highly profitable as some other commercial businesses in there. But the fact of the matter is we've got to perform in the second half. I think our guide is solid at IMS. We picked it

up to low to mid-11%. We're sitting at 11.7% year to date. So I think building confidence in our IMS team and their ability to perform. And biggest impacts would be the mix as we look at the second half.

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**Operator**

Sheila Kahyaoglu, Jefferies.

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**Sheila Kahyaoglu - Jefferies LLC - Analyst**

Thank you. Good morning, Chris and Ken. So maybe if we could talk about SAS on the top line and bottom line, what trends are you seeing in terms of ongoing growth in space and intel with the offset in airborne combat systems? And how do you think about the timing of airborne stabilizing? And any context you could give us on the return hurdles you're planning to have this disciplined profit fall through.

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**Christopher Kubasik - L3Harris Technologies Inc - Chairman of the Board, Chief Executive Officer**

All right, Sheila, let me start and then maybe I'll have Ken chime. Starting with space again, I think that is the example we keep holding off of what the benefit of the merger was in our trusted disruptor strategy. As I said before, we're the only company to have been awarded Tranche 1 and 2 for the tracking layer and the RFI for Tranche 3 just came out.

So the timing appears to be a little slower than we would have liked, but we're confident in our ability to continue with the with the SDA.

On the transport layer, we've taken the strategy of being a merchant supplier, so we'll have content on the transport layer as well when that is awarded and the classified continues to be a strength. So space and intel and cyber are the growth markets. Those are core competencies for us, and that's where the customer demand is.

We also have in there our mission network, FAA work, which is pretty stable, low single digit growth. And then again, as you mentioned, the airborne continues to have headwinds as a lot of these missions are moving from air to space, and we continue to have great capabilities on mission systems.

So to the extent NGAD is awarded, we have opportunities there. CCA, we have opportunities there. And in the interim, we continue to support F-35, F-16, F-18, and as such. So I think it's a story of space and intel growing and airborne continuing to be flat to down based on our customers' strategies and acquisition approaches. Ken?

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**Kenneth Bedingfield - L3Harris Technologies Inc - Chief Financial Officer, Senior Vice President**

Yeah, Sheila, from a margin perspective, I would say as we look at SAS, I think the biggest contributor to margin performance in the first half really has been the implementation of the LHX NeXt program. I think the team there has really embraced the program, worked really hard to get their cost structure where it needs to be and think about kind of how we deliver capability as we look forward.

Secondly, I would say we did take on and Chris mentioned a great example of it, which is SDA where we took on some challenging development work. It was a near adjacency, moving out of high-resolution weather imagery into missile defense with similar sensors.

And as we work through those development programs in '23 and now we are moving into the production phase, so off of trying to zero in Tranche 1, increasing quantities and then starting to see some volume as we move into Tranche 2, I think it's a business model that's really starting to pay off for SAS.

So I feel good about not just the margin profile, but I think importantly, some of the bets that we made are really starting to pay dividends in terms of our ability to perform and I think identifying the right bets to make with our limited resources.

So I feel good about SAS. And then particular, I think very strategic areas of growth, in particular space and the intel and cyber business, much of which is classified, but real solid opportunity there. And we see, I think a solid growing and performing business.

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**Operator**

Michael Ciarmoli, Truist Securities.

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**Michael Ciarmoli - Truist Securities - Analyst**

Hey, good morning, guys. Thanks for taking the questions. Maybe Chris or Ken, just back to Peter's first question on Aerojet, looks like second half of the year, the guidance implies, I think maybe a 14% to 18% growth second half over first half.

Can you maybe talk about what the drivers are? Is that more of the short-cycle volumes? I know you said you are really catching up on the past dues and then if you could just give us what that Aerojet book-to-bill was in the quarter?

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**Christopher Kubasik - L3Harris Technologies Inc - Chairman of the Board, Chief Executive Officer**

Yeah, let me Michael, give a little bit of an overview on Aerojet because I know it's been a year since we closed and 18 months since we announced the deal. So I'd like to look at this acquisition, as I said 18 months ago, strategically, operationally and financially. So I'll give some highlights for the first two and then ask Ken to comment on your specific question.

I will tell you we're not going to disclose book-to-bill by segment at this time. So appreciate the question, but you're not going to get an answer to that one. But strategically, I think, as I've said before, and I say again, I feel much better about this acquisition today than I did 12 months or 18 months ago. And it's clear that the demand is well in excess of the supply.

And you see that by lots of companies wanting to spend hundreds of millions or billions of dollars to enter this new market. So we are well, well positioned. And I think when I look at our portfolio, this is one of the faster-growing opportunities for L3Harris.

Operationally, there were some serious challenges that we've talked about. We've upgraded the talent pretty much across the board. We've doubled our on-time deliveries in 12 months, and we literally had thousands of overdue deliveries that we've cut by 40% in 12 months, I project it will be 60% reduced by the end of the year.

So we have red, yellow, green programs. We're getting more and more green programs each quarter. The customer relation is great. The technology is a discriminator. I can go on that longer if someone wants to know, but we have two pulse solid rocket motors. We have liquid and solid divert and attitude control systems, hypersonics is a huge opportunity over the long term, and we're continuing to invest.

We're breaking ground in Virginia next week on a new building. We've opened a couple in Camden. We have our ovens arriving later this month. We have new mixers coming in by the end of the year. So everything is paying off. We're investing our own money. We're using DoD, DPA money. We're using prime, co-investment money, and it's a great market.

And we love working for our primes and supporting them in their ultimate missile delivery. So just thought I wanted to give that context as to how much progress we've made in 12 months. Ken, you want to answer the financial questions?

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**Kenneth Bedingfield - L3Harris Technologies Inc - Chief Financial Officer, Senior Vice President**

Sure. Yeah, in terms of profile, Michael, I would say, you know, we've very clearly been focused and we talked about this on previous calls, I believe, really focused on integrating Aerojet into L3Harris. We've over-delivered, I think, on the integration savings and now the team is off really focused

on the long-term health of the business, the operational improvements that Chris talked about, and we're really not trying to drive the business for any particular quarter results.

I will mention Aerojet is primarily on the cost-to-cost percentage of completion basis. And as we look at the second half, we've seen as we're working with the supply chain that we should start to see some deliveries from our suppliers accelerate, which will drive some of the growth in the second half.

And as we continue to see that business grow, I think that profile will continue to build for us, not just in the second half of '24, but into 25. And so I think that business is being positioned very well. And as that work has been done and a great job by the Aerojet team, and doing that.

I think it really enables us to start to focus on it to Chris's point, delivering product, working with the supply base, working on the facilitation, the equipment, the improvements that we're making and using that kind of as a baseline to start to drive the growth and the opportunities that we see in Aerojet. So I feel really good about that. But I would say the biggest thing is just really working with the suppliers and getting the product in the door, so that we can and get the critical capabilities out to our customers.

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**Operator**

Scott today, Deutsche Bank.

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**Scott Deuschle** - *Deutsche Bank - Analyst*

Hey, good morning, Chris, appreciate the earlier comment on not disclosing book-to-bill by segment, but always found that disclosure to be pretty helpful. I'm trying to do analysis around what future growth would look like. So I guess is that disclosures that you contemplate bringing back at some point? Or do you just view it as not being relevant anymore? Thank you.

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**Kenneth Bedingfield** - *L3Harris Technologies Inc - Chief Financial Officer, Senior Vice President*

Yeah, Scott, it's Ken here. I would say from a growth perspective, we're providing guidance for the year by segment. I think we've in Investor Day, given a solid midterm financial framework with our gross \$23 billion in sales.

And you know, in terms of kind of how we guide, what we guide, and when we provide information, we're comfortable with the process that we're working through. And I feel like we've given a good set of transparency with the guidance across each of the segments, and book-to-bill itself can be a little bit lumpy quarter to quarter.

I think it's more relevant to think about on a long-term basis, and that's why we're really focused on providing that in annual disclosure. So we don't kind of get lost in the weeds on any particular quarter scenario. But in terms of the question around book-to-bill at Aerojet, I think we've seen an order or two sliding from the first half into the second half, but we're still planning to see a real solid book-to-bill for Aerojet for full year '24.

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**Operator**

Jason Gursky, Citigroup.

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**Jason Gursky** - Citigroup Inc. - Analyst

Great, thanks. One quick clarification question for you, Chris. And then I got one for Ken. On the clarification, Chris you mentioned that on RFI or maybe it's RFP, I'm unsure on Tranche 3 just hit. Just kind of curious what the volume's going to look like on that compared to Tranche 2, whether it's flat, growing, or shrinking.

And then Ken, for you, I'm just curious to know whether the success that you're having with the cost take-outs end up being a little bit temporal on the margin side of things, meaning that over time you give some of that back.

And I was wondering if you could just kind of help us kind of think through, you know, whether these margins expansion that you've seen here is just structurally higher or if we're sticking to the longer term guidance because you're going to end up giving some of this back, the cost savings that is, and I suspect this has an impact on revenue as well, particularly on your cost-plus contracts. If there's any way you can kind of quantify the impacts of NeXt on margins temporarily and then what it does to your revenue growth, if anything? Thanks.

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**Christopher Kubasik** - L3Harris Technologies Inc - Chairman of the Board, Chief Executive Officer

Sure. So two-part question. Let me address what I think was SDA Tranche 3 question first. And there I think is an RFI that's hit the street and we certainly don't want to get ahead of our customer in terms of what that looks like. But we are excited to be the only company that's been successful on Tranches 0, 1, and 2.

We will be analyzing that RFI and providing responses and certainly bidding as that RFP comes out and looks like maybe what was potentially a late '24 might not be a '25 acquisition from the government for that particular one.

And from a quantity perspective, I don't have that precise number in front of me, but I think it's either similar to Tranche 2 or I believe the overall quantity is similar to Tranche 2. I guess the ultimate question is do they continue with three providers or move to two, that type of thing? So we'll continue to work through that, but feeling really good about it, and I think we're making good progress on that program.

In terms of the second part of the question on LHX margin profile. Yes, absolutely, we are driving the LHX NeXt program for a couple of reasons, one of which is to enable us to deliver margin opportunity, but also, you know, to drive value for our customers as well. And that's not just from a cost perspective, but also includes schedule as the trusted disruptor, the ability to listen to our customers and respond quickly and provide capability at pace some.

But in terms of the specifics with respect to the cost savings, we have estimated roughly that about 40% of the savings will accrue to the company in terms of additional margin opportunity. So against the \$1 billion savings, we talked about essentially \$400 million of opportunity from a margin perspective, and we'll certainly work hard to continue to drive up both the amount of the savings as I think we're executing well on LHX NeXt and moving towards and gaining confidence towards our \$1 billion target.

So we'll work to make sure we get at least that amount, and then obviously working to see if we can maintain as much of that as opportunity for margin improvement benefit at the company as well.

You may remember at the time of the merger, we did realize, I think something between 50% and 60% of the integration savings. LHX NeXt is a little bit more of an enduring kind of three-year program versus the quicker integration. And because of that, we're projecting that a little bit more of it will accrue back to the government, which is a good thing, enables us to be more competitive, win more new business as we look forward.

But we'll certainly be working to see if we can find ways to realize margin improvements. And it may not be direct improvements out of the program. But as we return cost savings to the programs and they can think about how they perform better and are able to turn that into future profitability that we can bank down the road for future program performance, we'll certainly think about that as well.

So I think at the end of the day, the story is LHX NeXt, we are performing very well, I think we're ahead of schedule. I think we're building confidence, got more confidence today than we did just a quarter ago, and we will certainly work to drive as much of that into margin opportunity as we can. So thanks, Jas.

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**Operator**

Richard Safran, Seaport Research Partners.

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

Chris, Ken, Dan, good morning. I dropped off for some reason. So if you've answered this, I'll have something else to ask you. I thought you had some pretty solid free cash flow in 2Q beating expectations. You took up your operational guide but you maintained your \$2.2 billion free cash flow guide for the year.

Just wondering if you're expecting some working capital headwinds in the second half or maybe baking in some conservatism due to some risk with collections in the second half, so I thought maybe you'd elaborate on that a little more?

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**Christopher Kubasik** - *L3Harris Technologies Inc - Chairman of the Board, Chief Executive Officer*

Sure, Rich, and I appreciate the question and it hasn't been asked previously, so we're good on that front. In terms of free cash flow guide, we're at \$2.2 billion for the year. And as I think about halfway through the year, we're roughly 25% to our full year guidance. It's certainly not a profile that we are uncomfortable with. It's kind of about where we are normally this far through the year.

We've got a fair amount of cash to generate in the second half, but we're comfortable, absolutely reiterating the guidance at \$2.2 billion. And I don't think we're expecting any working capital build necessarily in the second half, but we've got to work with our customers, get the payments coming in the door, work with our suppliers, making sure we're paying the term on those fronts.

And the way I would characterize it, similar to Jason's question on LHX NeXt is we're building confidence to our guide and maybe as importantly, we're sticking with our guidance in the 2026 financial framework of \$2.2 billion in '24, \$2.4 billion in '25, and \$2.8 billion in '26.

And that's kind of the bigger picture that we're thinking about is how we continue to build confidence into that increasing free cash flow as we grow the business. And quite frankly, as we get the net leverage targets where we need to be, hopefully, by the end of '24, and we start to deploy capital with a little more of a tilt towards share repurchase, really driving our ability to see some free cash flow per share growth as we look out into '25 and '26.

So feeling really good about it. I think it's a great profile, and I think it's a really solid part of our story with that midterm financial framework. And again, I think we're just building confidence towards that, and I feel really good about it. So thanks for the question, Rich.

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**Operator**

Pete Skibitski, Alembic Global.

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

Yeah thanks, good morning guys. Hey Chris, going back years to L3, you guys had done a number of niche acquisitions in the unmanned space, especially unmanned maritime. And I believe all those units came over to L3Harris, but we haven't really heard about the focus on unmanned at L3.

I'm just wondering, is that still an interesting area for you, I know that DoD is kind of still experimenting, trying to figure things out, but is there anything chunky out there contract-wise that you're looking towards or still early days, just want to get your updated thoughts on that whole area?

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**Christopher Kubasik** - *L3Harris Technologies Inc - Chairman of the Board, Chief Executive Officer*

Yeah, Peter, great question. The whole undersea and autonomy markets are growth markets for us. I would say on the undersea, what we're seeing more is on the sea beds, the sensors, lot of classified work, which are not the autonomous ones. We refer to those as grotto and there's a big opportunity coming up almost \$1 billion where we're competing.

This would be the third opportunity, we won two already. So that could be a real growth engine for maritime. Relative to the autonomy, we still are doing well on the autonomous surface vehicles. I think the Navy is still developing its autonomous strategy and relative to the unmanned undersea, these are relatively inexpensive products.

So we continue to invest. We've had great success with our torpedo launch and recovery using an unmanned undersea vehicle, which is kind of a game changer. But we can highlight it more, but these are literally -- you sell 20, 30, 40 of these. It just doesn't add up to a lot of money, but it's critical to the mission and we should be able to start seeing some export opportunities here in the years ahead.

So still part of the portfolio, still doing well. Just the price of the products are relatively inexpensive and probably don't roll up to the materiality to talk about them, but we'll try to do more in the future.

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**Operator**

Ken Herbert, RBC Capital Markets.

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**Ken Herbert** - *RBC Capital Markets - Analyst*

Yeah, hey, good morning Chris and Ken. Maybe I wanted to ask Chris on the CS segment, it sounds like there's going to be a nice mix shift for international in the second half. And you called out some pretty substantial opportunities as we think about tactical radios and other aspects of that market.

But maybe can you just talk about the competitive landscape and to what extent you're seeing incremental price pressure there on the tactical communications side, in particular, and how you might be thinking about the opportunity to maybe take share, especially in international markets?

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**Christopher Kubasik** - *L3Harris Technologies Inc - Chairman of the Board, Chief Executive Officer*

Yeah, Ken. Good to hear from you. Domestically, they tend to split the buys, as we've talked about before, 60-40, 70-30, and such, and we're usually the winner of the majority share. But internationally, it is a winner-take-all environment. And generally, we've had great success. And again, these are relatively inexpensive compared to other weapon systems or products out there.

So the price is not really that much of a differentiator and pricing strategy, we have a price target. We know what the costs are and as you know, we get reasonably good margins in this business. So we don't plan on lowering the prices and the customers see the benefit of our technology and again, the interoperability.

So we try to cut a fair business deal. But I feel real good about what we're doing. And we've been able to take cost out through our LHX NeXt initiatives. We're getting dual source suppliers. So we don't have single points of failures across the company, but especially in CS and feel real good about this portfolio and the market opportunity.

So I think we're going to be in good shape. I'm not going to mention any specific countries, but there's a lot of big opportunities here in Europe that are going through the FMS process and we should have a good second half of the year.

**Dan Gittsovich** - *L3Harris Technologies Inc - Vice President, Investor Relations*

Rob, let's take our last question.

**Operator**

Gavin Parsons, UBS.

**Gavin Parsons** - *UBS Investment Bank - Analyst*

Thanks, good morning. Guys, I just wanted to go back to the supplemental if you could give a little additional color. I think you'd said maybe there was going to be some additional radio revenue in there. Is that upside potential through the end of the year or into next year, is that more of a derisking factor for the guide?

**Christopher Kubasik** - *L3Harris Technologies Inc - Chairman of the Board, Chief Executive Officer*

Yeah, it's built into the guide. And again, it's always hard to predict the actual quantity and timing and the congressional approval process. But a lot of that money for a variety of countries flows our way, either directly in the radios, a little bit on night vision goggles, and then indirectly through the solid rocket motors supporting the primes for the ammunitions. So I think that gives us confidence and stability in our guide. And as you suggest, some of this should roll into 2025 as we make the deliveries in the next 12 to 18 months.

So with that, before we sign off, I always like to thank our employees for their hard work and dedication. We believe we're truly changing the industry, and I'm proud of what they've accomplished and we've accomplished in the last five years. We're very optimistic about the future, and we look forward to talking to everybody in the months ahead. So thanks for joining the call today. Have a good weekend.

**Operator**

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

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