

REFINITIV STREETEVENTS

EDITED TRANSCRIPT

LHX.N - Q1 2022 L3harris Technologies Inc Earnings Call

EVENT DATE/TIME: APRIL 29, 2022 / 12:30PM GMT

OVERVIEW:

Co. reported 1Q22 results.

CORPORATE PARTICIPANTS

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

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

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

CONFERENCE CALL PARTICIPANTS

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

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

So as you'd expect, we're investing R&D and capital to continue to support the program and find more efficient ways to meet these commitments. And I do want to recognize the team because we are working effectively 3 shifts and weekends. This is the highest priority for everyone. And we've had customer visits, and they've been very complementary of the workforce and the progress that we're making. So Michelle?

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

Yes. So just to add a little bit of color from a financial perspective. So our overall Mission Avionics sector is going to be down mid-single digits, consistent with what we shared before. The F-35 development is going to be down low double digits before we get into the -- we ramp from a production perspective. So we anticipate going into next year that we'll be flattish to up a couple of percent.

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

Yes. So let me go back to the first question about the Agile Development Group and our investment in Shield. So you've heard us talk about our strategy of being a trusted disruptor investing more in R&D as a percentage of revenue than most, trying to prime more contracts and embracing

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

Thanks so much for the bold, new, efficient format. I like it. I think Slide 16 or Page 16 is my favorite, though. So Chris, since the last time we spoke, there's been a lot of change. The budget came out. It was more robust of an outlook than we thought, coupled with NATO members stepping up defense spending.

So given your ability to be perhaps more nimble than others, what are you seeing in terms of incremental opportunities? And how do you think that could impact the intermediate growth profile of LHX?

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

Okay. Well, thanks, Sheila. We'll obviously welcome all feedback on the new investor letter. But I think we got a lot of positive feedback, giving you 15 hours to read it instead of 1 hour. So hopefully, that was helpful.

Yes, on Ukraine -- and I'll just say Ukraine and the whole region, the breaking news yesterday was you saw the White House asked Congress for an additional \$33 billion of funding. And when you look into the details, which I know will evolve over time, \$20 billion is for defense. And of that, \$6 billion is the USAI, which is the Ukraine Security Assistance Initiative, and \$6 billion is FMS. And those are 2 vehicles and processes that we're very familiar with, and we've used over the last several years or decades in supporting Ukraine. So I think we understand how that process works, which, of course, is very important.

The \$6 billion compares to \$300 million last year. So this is a significant increase. And we just need to see how long it's going to take to get this bill passed. As we read it, it appears to have a lot more flexibility for acting quickly to get these contracts moving.

So as you would imagine, we're in discussion with several customers in the region and here in the U.S. There's lots of opportunities for L3Harris. When you think of secured communications, I think it's been pretty well publicized, the importance of having secured communications. And that's worked well with Ukraine, a longtime customer of ours. I think you can read and see that the Russians are having difficulty with the communication. So I think that positions us well.

We have, just under the whole ISR, situational awareness, whether it's space ISR, air ISR, even the EO/IR turrets out of WESCAM are examples of things that I think could be needed and, of course, night vision goggles. So we're really not able to give a lot of details, as you would imagine. But I think, broadly, we're well situated. And many of these capabilities are in our sweet spot, even including EW, electronic warfare.

So I think over the midterm, we continue to believe low to mid-single digits is the right guide at this point in time. We are starting to get demand signals. We're responding to RFIs. But I do like the tailwinds, and I think more to come over the next several quarters.

I will say relative to being more agile or nimbler, I can't give you the specifics, but I can tell you, within 15 days from receiving a request, we were able to ship product to help with the conflict. And just so you know, a lot of this is reprioritization, right? So we have other customers who are willing to give up their products, to get them over in the region. And then we have to obviously backfill those as well.

So I don't know if that got to all your point, Sheila, but that's -- I think we're well situated.

Operator

Our next question is from the line of Robert Stallard with Vertical Research. [O5Tj1 0G1 0 15oGil buui0nkm5UdTf1 0os26 193.I situate140.6 lh3l buui0n3 193.](#)

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

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

Thank you for the very efficient format, both last night and in your opening comments. I had a couple of questions related to one another. So if you could just broadly characterize kind of how LHX fared in the FYDP forecast? An open-ended question. If you could talk about radios. You've won a number of IDIQs, night vision, what have you. So take it as far as you'd like, but talk to us about the FYDP and how you guys are positioned?

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

Okay. Did you have more? Or just -- is that your only question?

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

Meaning of life and other questions as well, but we can defer that.

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

Okay. Yes. I mean, as we saw -- the good news is we did get a 2022 budget finally. We've talked, at length, of challenges. It's taken 165 days to get a budget. But nonetheless, we did get a budget. Now we're starting to see some contracts and activity pick up at a quicker pace.

For '23, I think we've all seen, just focused on the top line, the \$773 billion top line. In my discussions with several customers and members of Congress, I believe that number is actually going to go up during the conferencing process. I think we've seen about \$20 billion on the UPL list, the Unfunded Priority List. And I think the majority of that is going to be ultimately rolled into the final 2023 budget.

Relative to -- I'll just go to the Unfunded Priority List first. You did mention night vision. That was in the budget as zero. It was zeroed out. But ourselves and our competitor are aggressively working the Hill to get that funding back in, with the concurrence of the Army. We generally don't go to the Hill without our customers' support.

So the fact that, that's on the UPL list, I think, is a positive. So that was probably the one thing that caught our eye on the negative side. But on the positive side, I'll let Michelle talk a little bit about the IDIQs.

Everything we looked at seemed to align well with what we wanted. I mean, we track all of our current programs, but we also look at new opportunities. We're very aggressive in bidding, opening the aperture and looking for new opportunities. And we like to make sure those opportunities are funded, even though they're competitive because, over the long run, we think we're well positioned to win some of those.

The only thing I'd just also throw out beyond DoD is NOAA. I mentioned that we're well positioned with the next-gen weather satellites. The NOAA budget went up 17% '23 over '22. NASA is up 8%. Even the FAA, where we do a lot of work, is up 4%.

So when I look at DoD, NOAA, NASA, FAA, and then I think we've all been following the international budgets are trending up, especially in the NATO countries. I just see this as a lot of positive tailwinds that put us in a good position to continue to grow for the foreseeable future.

But maybe I'll give it to Michelle to give a little more color.

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

Yes. No, I agree. I think often, in recent discussions, our radio business has been overshadowed by our supply chain challenges. But when you look at the predictive indicators, whether we're talking about the budgets with double-digit growth on our handhelds or the IDIQs that we received within first quarter. \$10 billion of IDIQs really speak to a predictive indicator on the overall growth within this business.

And so we're excited about the near term. Going back to Sheila's question around the immediate opportunities that we're getting from the conflict environment as well, all of the macro indicators would suggest that we're going to have a tailwind related to this business. So we're excited about what's to come. We do need to get through the hurdle, however, with the immediate supply chain challenges.

Operator

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

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

I appreciate the new format like everyone else. I think it's really efficient. Chris, I guess my question is just leaving off from what Michelle just mentioned on the supply chain. Just your comfort level around kind of things improving in the second half. And then also just how it relates to maybe you taking a more cautious approach and carry more inventory as we kind of look towards this kind of building budget environment and just kind of have -- adjusting case supply versus kind of targeting your working capital days that you've been highly focused on?

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

Yes, thanks. No, that's a great question. Clearly, that's the #1 risk that we're all following and have been talking about for at least the last 9 months and maybe longer. But to put it in perspective, from last time we had a conversation, I would say it's about the same. It feels like we're making progress.

Every day is different. We get 2 steps forward, 1 step back. I think the only thing that's changed in my mind is maybe the length of the recovery. There's a belief that this was going to all be behind us in 2022. I think it's going to go into 2023.

And again, when I look at supply chain, I put it in 3 buckets: we have inflation, we have materials and we have labor. I think I've covered the inflation in a prior question. But again, we're kind of in the mid- to high single-digit rates, depending on which index you're looking at. And we know it's going to come back down to lower single digits. But I'm thinking it's 2023, where, previously, people might have projected fourth quarter of this year.

The materials is mainly the electronic components. We've talked about our investments in a variety of tools, data analytics. And those processes are paying off as we get better visibility. But at the end of the day, the lead times continue to extend. And even the freight and shipping challenges are adding to the complexity, just getting the products into the country and, of course, the increased cost of just shipping everything.

And labor -- the labor shortage. I think the attrition is up pretty much across our industry, and that's something we've got to figure out how to address. But I think the labor shortage is even more significant within the supply chain, so therein lies the challenge.

We've been very successful in our new college grad recruiting. So that's working well from our perspective. But I'd say, feel about same as I did 90 days ago. Just a little longer recovery is the way I think I would summarize it.

I don't know, Michelle, if there's more?

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

Yes. Yes. So I can add a little bit from a numbers perspective. But I do -- just because of the complements that we received on the Investor Letter, I do want to thank Rajeev and the IR team, along with our controller team, communications and legal, a lot of collaborative effort went into creating this. And we feel like it's really a win on many levels.

But the one that I would highlight for this group is really how we're living into our DNA of being a trusted disruptor across the organization. So it's not just about our products and technologies, it's about how each and every one of us show up differently to ensure we're a differentiator.

So on the supply chain front, just to put some context from a numbers perspective, in first quarter, we expect this is going to be slightly under \$100 million in terms of the top line impact. We expect that that's going to be fairly consistent in Q2, with the recovery happening in the second half and into 2023.

And so to Chris' point, I think it's very consistent with what we -- where we were at in January, except with a potential elongation into 2023 as well. But I do think it's also really important going back to the budget conversation to note that this is all about timing, in particular, within tactical radios. The demand for our products remain very strong. And so it's really about getting through this short-term lift from a supply chain perspective.

Operator

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

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

I'd like to continue on the tactical radio side because when I think of the products that you've got here, I mean, this is sort of the -- I think of it kind of post-jitter's world, where you're trying to have common waveforms. So you need a lot of interoperability.

So it means you have to -- and my sense is it means you have to really outfit large portions of the military. And when you think about the IDIQs you've gotten, can you talk about how those -- how you expect those to play out in terms of, in a sense, completing the deployment over time of the radios that the Army, the Marines, that they need over time? And then second, how do you think about the conversion of those IDIQs into revenues in terms of your share, in terms of the timing of individual awards?

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

Yes. No, Doug, great, great questions. Yes. So we can -- let me take the first part, maybe at a higher level, and Michelle can give you some of the actual numbers that show you what we're doing relative to orders and revenue kind of quarter-by-quarter and the outlook.

So no, look, you're absolutely right on the importance of these radios and the resilient communications. A lot of our R&D goes into new waveforms. And as we've said before, the modernization is still in the early phases. So we talked about the SOCOM 2-channel multiband handheld. That's an almost \$400 million IDIQ. It's a little over halfway utilized, which a little over half of the terms of the program is actually in the final stages of the program.

So the -- step one, as you know, is to win the IDIQ, kind of call that the hunting license. And then you go task order by task order, year by year. So we're in really good position. And the modernization will continue. Secured comps and situational awareness are 2 key things you need in any conflict.

Before handing to Michelle, I will point out, notwithstanding some of the headwinds and volatility in our tactical comm revenue, we still have not

Look, we've got a plan of about 1.05 book-to-bill. So we're looking at being over 1.0 each of the next 3 quarters. We might be a tad on the conservative side, but we did have a CR through mid-March. And now we have to actually convert these into actual contracts. So that's the process we're going through.

I see international as a tailwind as well. We have some great opportunities for international ISR. We have our EO/IR turrets. And we just have to go through the process. We have congressional notifications and dealing with foreign governments and their approval process.

So we think we're in a good position. A lot of these are sole sourced that we're just going through the contracting and export and approval process, and I would expect those to close as planned. So hopefully, over -- in the 1.05 range for this year. We haven't given a lot of insight into '23, but we kind of use that as probably a benchmark for '23 as well.

Because they keep -- we keep talking about the tailwinds each and every day, there's -- everything seems to be positive relative to the demand signals that we're getting. We just have to win and then move forward.

In fact, we we're going to be announcing, but the Navy announced something that we're quite excited about. That was a recent award known as SPEIR, which is the Shipboard Panoramic Electro-Optical Infrared System. And why I want to bring this up is it aligns perfectly with our strategy, which is to invest upfront in R&D, prime more opportunities and then embrace new entrants or flip the paradigm and have some of the more legacy primes on our team.

So we'll get a press release out on this one shortly, but it's a \$200 million EMD opportunity and just under \$600 million with options. And that's just for 21 ships for the U.S. Navy. We believe it could be upwards of 100 ships. And of course, we have the international market.

So it's a competitive win. We started this actually 6 years ago by investing our IRAD or R&D on passive targeting, 8 different businesses within L3Harris working together collaboratively. This is a multibillion-dollar opportunity that we're really excited about, and it provides 360 EO/IR passive detection and tracking, which is what our Navy needs.

If you want to put it under the JADC2 umbrella or whatever, this is a big deal. It's modular, it's open systems, and it's something that you'll see more in the days ahead. And then we're waiting for award on something called Spectral with 11bips for r l61 36 4modulara 4modulara 4moGINT,rnation onmar

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

Mix, I wanted to touch on it. I think it was a -- it sounds like it was a benefit to IMS in the quarter, but a negative on SAS. And I think for the full year, it's supposed to be a headwind to both of those segments.

So if you could just touch on kind of the big moving pieces when we think about the mix and the impact on margins. And then could you also just touch on the size within -- I think it's within IMS now, Commercial Aviation, how big that business actually is now, given you've sold off a decent chunk of it? And where that, I guess, that stands relative to like-for-like pre-pandemic levels?

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

Yes. David, so I'll start, and then Chris can jump in. From an overall mix perspective, to your point, our segment margins came in at 16%. You'll know that our guide is 16% to 16.25%, so we came in on the low end of that. But to your point, there was certainly some mix variation when you looked across our segments.

So I'll start with IMS. They had a really strong quarter, landing at 14.8% and comparative to our guide of 13.5% to 13.75%, really strong execution. So big complements to Luke and our ISR team, but also overall program mix within our Commercial Aviation business. So compliments to Alan and his team as well.

This is the fourth consecutive quarter of double-digit growth within our commercial aviation sector, and we're expecting that to continue to grow in the second half as well. And so really strong EAC performance. We do expect that to modulate a bit as we get into second half to align with the guide that we provided.

And then to your point, the opposite dynamic is actually playing out within SAS. So we landed Q1 at 11.9% versus a guide of 12.5% to 12.75%, which implies that there is going to be increased expectations from a productivity perspective and mix.

Now we did have a really strong quarter from a space perspective within SAS. That's a lower-margin business for us with a lot of the new program wins within it. So we expect that, coupled with our e3 savings, to help that business in the second half of the year.

And then finally, from a CS perspective, we talked a lot about supply chain today, but that was clearly a headwind within Q1. We do expect with the volume recovery0d.

Operator

Our final question comes from Michael Ciarmoli of Truist.

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

I love the new format. Chris, just -- and maybe, Michelle, back to the international and the demand environment, I guess, if we looked at the growth trajectory really in the industry prewar, it was really going to be driven by U.S. DoD modernization, next-generation programs in this R&D phase

Operator

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

DISCLAIMER

Refinitiv reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES REFINITIV OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2022, Refinitiv. All Rights Reserved.