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LHX.N - Q3 2023 L3Harris Technologies Inc Earnings Call

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OVERVIEW:

Company Summary

around the world. As we embark on our fifth year since the merger of L3 and Harris, I'm proud of our achievements. We've built a diverse and seasoned team that is integrating our company.

L3Harris is viewed as a disruptive competitor that is reshaping the U.S. defense industrial base. Meanwhile, underpinning our strategy is a focus

and flow and deliveries. We've supplemented the existing leadership teams at some of the key locations in Alabama, Arkansas and Virginia with resources and experience that I think is going to start showing immediate results.

And then we've deployed resources to our sub-tier suppliers. And that really is the challenge in the munitions and rocket motor business is a couple

Michelle Turner - *L3Harris Technologies, Inc.* - *SRVP & CFO*

Yes. So thanks for the question. From an overall Comms perspective, we continue to be on track to deliver to our guidance, which was double-digit growth across the business, which includes to your point, (inaudible) the abating supply chain challenges which we continue to see along with the acquisition of our Tactical Data Links business. Specific to radios and comms from an overall DoD budgetary perspective, we continue to see support. We're about 40% of the way through that modernization program. And we continue to see strong demand internationally as well. And so overall, I'd say, we're feeling like we're in a good place from a Comms perspective.

And then just from looking at supply chain specifically, we continue to see hiccups like you're hearing across the industry, but significant complements to our supply chain, our Tactical Communication business, Sam Mehta, Chris Aebli. The efforts that they've put in over the last 18 to 24 months in truly building a resilient supply chain that allows us to pivot when we continue to experience these hiccups is enabling us to continue to deliver

Aerojet Rocketdyne, we talked about the munitions. We are in the rocket motor, solid rocket motor business supporting great primes who ultimately integrate the missile. So I feel comfortable with our position there. Michelle talked about the radios. We made an acquisition earlier this year on Tactical Data Links from ViaSat. And we keep talking about the connectivity of this network, and it is happening and it is going to happen. It's hard to find the budgetary numbers, but these different domains, space, air, land, sea, they have to be able to connect cross services, multi-domain, all those buzzwords we hear, but it's critical and it's happening and someone was asking me best to try to explain with waveforms and all these different things that we're doing with Link 16. And I think the simplest way I could come up with is just categorizing it as stealth communications. I think that's kind of a simple way to look at it.

Within our CS business, I'm getting specifically to your question, Scott, CS delivered consistent with our expectations within the quarter along with consistent with Q1. And so we anticipated Q3 to be lower margins aligned with a heavier DoD shipment mix from a tactical radio perspective. And

bid fixed-price development programs that simultaneously ask for development and production, as I've said before. It's hard enough to estimate the development, let alone commit to production for 1, 2 or 3 lots in '26, '27 and 2028. So we will continue to no-bid those.

But 2024, 1-year CR, which I'm not at all suggesting will happen. But the one thing we can all agree on is we have no idea what's going to happen in D.C. And I kind of want to get through November and get some of those things behind us, including world events. But right now, it looks like we're going to experience growth -- top line growth in all segments. And on a consolidated basis, which we'll be talking about in December, I expect cash and OI and EPS notwithstanding pension headwinds and revenue to all grow. So that's encouraging, but details to come.

Operator

Our next question comes from the line of Ken Herbert with RBC Capital Markets.

Michelle Turner - *L3Harris Technologies, Inc.* - *SRVP & CFO*

Yes. Thanks for this question. I'm glad we're getting to talk about it a little bit more. And so this is the next phase of our L3 and Harris merger evolution, if you will. And so if you think about the initial integration savings that we did as a company, several hundred million along with some offsets, this is the next phase of this, kind of the harder parts, if you will. And it's really focused on leveraging our scale to drive efficiencies and also functional organization to ensure that we're optimized for value creation. And so to your point specifically around the overall bottom line impact, we do anticipate that there's more investment that goes along with this phase of the journey, Matt. So you'll see in our investor letter, we laid out about \$400 million of investment.

And so you should think of this more as a nominal tailwind from a margin perspective and not flow it all to the bottom line. But I do want to highlight a couple of tangible examples that the teams have already driven as we're in the early stages of this, just so you can start to characterize what are we talking about and we're talking high level about LHX NeXt.

And one of our recent wins, I'll complement our HR team and Melanie Rakita, they've done a fantastic job in renegotiating our employee benefit package, again, leveraging the scale of the new L3Harris portfolio to not only increase our benefits and also save on costs, but we're also going to be holding our employee benefit cost flat to our employees. So this is really creating a win-win opportunity, both from a shareholder perspective

Operator

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

Mark Kratz - L3Harris Technologies, Inc. - VP Investor Relations

Rob, this will be our last question this morning.

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

Just stepping back, big picture, your margins are 15% today. How do we think about expansion from here? Is it possible? And then to that extent, maybe specifically on communication systems, can you talk about the puts and takes there? Can you shake off some of these supply chain issues? And how do you think about the improvement progress and just the core margin of that business and run away from here?

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

Okay. I think I'll take this one since it's our last question, Sheila, and I guess you snuck in right under the wire here. So good morning. Yes, thanks for acknowledging the 15%, which I think are industry-leading margins, which we are quite proud of. And even though they are industry leading, we are committed to find ways to continue to grow those margins.

So on the CS side, we do have the commercial model -- commercial business model, which has played well for us. And that goes beyond just the tactical radars we also have at WESCAM with our turrets and some of our sensors. So I think that's just an area that we need to leverage. We've been increasing our prices to cover the dilutive effect of the cost increase. And I think that's something that this industry doesn't naturally do. I think we all see in our day-to-day lives, prices are going up all over the place. So we tend to try to want to hold pricing flat. But the new reality is it costs you more to buy components and labor.

And Michelle mentioned holding the employee benefit costs flat for 2 years in a row. Those are going to be priced into our products, plain and simple, and that's going to help keep the profitability where it is, if not maybe even increase it. And again, we'll try to leverage the supply chain, the power of the enterprise. We recently had some successful negotiations by working across all the segments and sectors, getting all the buy together and negotiating at a corporate-wide basis for actually direct material, and everybody does that for indirect, but direct is a lot harder, and we were able to pull that off. So I think that's a key part of it.

We haven't talked about e3. That is just in the DNA. It's something we do every day, and that will continue to offset some of the headwinds and contribute to our bottom line. LHX NeXt, as Michelle gave a great description, I think, is really a key differentiator for us. It's the continuation, like you said, of what we started with the merger. I think we did the easy stuff first, and this is the harder piece and the ultimate goal is to simplify the business and change the way we do business. Everyone wants to just take an arbitrary cut to lower their G&A or overhead, but we are looking at everything and seeing if we can eliminate it, do it differently. And she gave some good early examples, but I think there's a heck of a lot more we can do, and that will contribute to lowering our cost base, which will make us more competitive and/or contribute to the bottom line.

And I said it earlier, and I think it's the tr1soh lowering our tl wha arbij0. atbility wgreISmy wsqand

and we will win cost-plus programs. And we all know those margins are dilutive. But I look at it on an ROIC basis, it's effectively infinite. So if we can get 9%, 10%, 11%, 12% cost-plus jobs that lead to low rate production, that lead to full rate production, that lead to exporting, that is the grand slam of new business, we will bid it each and every time. And it's a portfolio, as Michelle said, we run the company as a portfolio, we look at our financial results as a portfolio. Some segments have a good quarter, some don't. We put it all together, I could not be more proud of the team and what we were able to accomplish in the third quarter, the exceeded expectations on revenue, EPS and cash and it's something we're quite proud of.

So I think with that, I'll just thank everybody for joining the call this morning and another shout out to the employees for really coming through and delivering a great third quarter. I know we're all working hard on Q4, and I can't wait to see everybody in early December for our Investor Day down here in Florida. So with that, we will sign off, and thank you again.

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.
