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PRESENTATION

Operator

Greetings. Welcome to the L3Harris Technologies First Quarter 2024 Earnings Call. (Operator Instructions) As a reminder, this conference call is being recorded.

It is now my pleasure to introduce your host, Mark Kratz, Vice President of Investor Relations. You may now begin, Mr. Kratz.

Mark A. Kratz *- L3Harris Technologies, Inc. - VP of IR*

Thank you, Rob. Good morning and welcome to our first quarter 2024 earnings call. Joining me this morning are Chris Kubasik, our CEO; and Ken Bedingfield, our CFO. Yesterday, we published our first quarter earnings release detailing our financial results and guidance. We also provided a supplemental earnings presentation on our website.

As a reminder, today's discussion will include certain 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 our SEC filings. We will also discuss non-GAAP financial measures, which are reconciled to GAAP measures in the earnings release.

I'd now like to turn it over to Chris.

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

Thanks, Mark, and good morning, everyone. Since the merger of L3 and Harris 5 years ago and after strategic acquisitions and targeted divestitures, we have built a company with a national security focus. We have critical technologies in all domains that align to national security priorities and the global threat environment. Responsive space, resilient communications and rocket motors are critical for the future fight. The trusted disruptor strategy and our portfolio are setting the stage for L3Harris to differentiate ourselves with top line growth while simultaneously increasing our industry-leading margins.

The global security environment continues to be one with heightened tensions and regional conflict. Domestically, Congress recently passed the 2024 Appropriations Bill, which included $844 billion for defense. Our programs are well funded, and we are positioned for profitable growth across much of the enterprise. Demand remains strong for our products and solutions as we started off the year with a 1.06x book-to-bill ratio.

Internationally, we continue to see a strong and geographically diverse pipeline of opportunities. As an example, we were recently awarded a $150 million program to provide secure networking to Taiwan, displacing a long-time incumbent. This win is an integral part of our interoperability and supports the CJADC2 mission.

Turning to tactical radios. We maintain a robust international pipeline of over $10 billion, including several FMS cases, primarily for Europe, totalling

Operationally, we continue to make progress within our Aerojet Rocketdyne segment. Since closing the acquisition, we've implemented processes and tools, which have helped reduce late deliveries by 20%. We've returned multiple programs back to green, and we continue to work with our customers and the DoD to accelerate and improve deliveries of these critical products and to support future growth.

Aligned with that growth, it was recently announced that we were selected to be the primary propulsion provider for the Missile Defense Agency's next-generation interceptor. We anticipate this to be a multibillion-dollar opportunity over the life of the program.

Outside of operations, our finance team saw an opportunity to refinance some variable rate debt and replace it with fixed rate notes, saving 150 basis points. On capital deployment. We increased our dividend for the 23rd consecutive year, and we were able to get back into the share repurchase market in Q1, executing about half of the 2024 share repurchase target. We expect about $1 billion in gross proceeds from the previously announced divestitures, which will largely be used to reduce our leverage below our 3.0 target ratio.

We remain focused on achieving the financial framework we laid out at Investor Day, and our first quarter results are a solid step forward towards delivering on our commitments.

I'll now turn it over to Ken to provide additional perspective.

Kenneth L. Bedingfield *- L3Harris Technologies, Inc. - Senior VP & CFO*

Thanks, Chris. Let's start with consolidated results for the quarter. We reported solid gains of $5.5 billion, including over $900 million for SDA tracking Tranche 2, nearly $150 million for U.S. Marine Corps and SOCOM handheld tactical radios, and an international award for a NATO country for missionized business jets that leverages our domestic ISR capabilities.

Backlog remains at over $32 billion and supports margin expansion opportunity as we move forward given operational improvements and recent bidding discipline. Revenue grew 17% and 5% organically with growth in 3 of our 4 segments. Revenue at IMS reflects aircraft procurements in Q1 '23, resulting in lower sales in Q1 2024. As Chris mentioned, operating margins expanded to 15.1%, up 80 basis points from improved operational and program performance while also starting to see the benefits of LHX NeXt.

EPS grew 7% to $3.06 per share primarily from segment operating margin performance, partially offset by higher interest expense and lower pension income. On a pension-adjusted basis, first quarter EPS was up over 10%. Free cash was an outflow of $156 million as first quarter cash flows are typically the lowest of the year. As you will recall, we derisked 2024 cash taxes at the end of '23, and we remain confident in delivering free cash flow growth this year to $2.2 billion.

I'd now like to turn to some segment details for the quarter. I highlighted earlier that revenue grew 17% from the acquisition of Aerojet Rocketdyne and organic growth in our SAS and CS segments as we continue to see strong demand for Space Systems and Tactical Communications businesses.

On margins. We drove operational improvements throughout each of our 4 segments. In SAS, we are making progress on development programs, including the recent launch of 5 L3Harris missile-tracking satellites as part of the SDA tracking Tranche 0 and HBTSS programs. With these space investments and risk largely behind us, we are beginning to realize the benefits of the new growth areas and maturing processes as we move forward. These efficiencies were a contributing factor in expanding SAS margins by 100 basis points in the quarter.

We made progress on program performance, resulting in a $75 million improvement in net EACs versus the first quarter of 2023. These were driven by improvements in all segments as our focus on operational rigor continues to pay dividends. This was most prominent in our CS segment, where the Integrated Vision System sector saw stronger results. The Tactical Data Link Q1thetypmersnong demand for Space Sys0 0 1 36 1 36 ts for. Let's nue gan

Kenneth L. Bedingfield - *L3Harris Technologies, Inc. - Senior VP & CFO*

Yes. No, from an LHX NeXt perspective, we are adjusting out the implementation costs of the program and certainly then trying to leverage the benefits of LHX NeXt in the businesses. We talked about what that target looked like for 2024, and the businesses are off working hard to operationalize that and reflect that benefit in their performance. And I think you're starting to see that here in the first quarter. And then from a cash perspective, we're primarily just adjusting out the cash severance costs related to the program. And you'll see all that reflected in the schedules to the earnings release.

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

Yes. Look, we've gotten the feedback relative to our disclosures. So under Ken's leadership, we're trying to cut back on these onetime non-GAAP adjustments and be much more transparent. So I think it will be all laid out clear for you to analyze.

Operator

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

Peter John Skibitski

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

Yes, Kristine, it's Chris. We did set up the ad hoc Business Review Committee of the Board comprised of 4 Board members, as you saw. We've been meeting a couple of times a month for a few hours each. And we brought through a variety of topics that have been laid out in the charter that we filed in the 8-K.

I would say from anything from operations, we've looked at the programs, they've reviewed the program review procas 3c'cbiddthin procas 3c'cC proc70p.9

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on what's optimal for LHX and then in related to all the actions that you've been taking. Also on portfolio shaping, just in terms of any future kind of thoughts that you've had on further shaping the portfolio.

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

Yes. No. Thanks, Peter. So yes, the workforce is probably the quick hitter for what we need to do for LHX NeXt. And as you said, that got us about 1/3 of the way there. The next part is going to be a little more timely and a little more complicated. And the facilities, I think, are going to be a key part of it.

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

mid 24% for the full year, we are looking at some international opportunities to realize some additional margin benefit as we think about that kind of full year impact. And I think -- so that's what we're trying to communicate on CS margins from a Q1 and full year '24 perspective.

And then from the international side. Clearly, as Chris talked about in his prepared remarks and in response to Jason's question, a lot of international opportunity at certainly the CS segment. But as we look beyond that as well, we see international opportunity, in particular at IMS and certainly, the other segments have international components to their business. We don't necessarily track some of the ultimate end customer quite as closely in some of those. But the international margins tend to be stronger across the board.

In my remarks, I talked about an ISR program by a NATO country. We would expect that would have strong margins as we, again, think about how we make those deliveries to our international allies and our country's partners, and recognizing the different risks and channels that come with those programs that should you perform, and we expect to be able to perform, will generate higher margins for the business. So we do see that continuing to move into the business.

I will comment, CS clearly is the kind of the quickest-turn segment, the shorter-cycle segment in terms of ability to take international orders and turn it into sales. So just an example, that ISR program we talked about will be a multiyear program, and we'll see that kind of move into the revenue over a bit more time. But with that, I'll turn it to Chris for a few more comments.

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

Yes, Ken. Just as a reminder, we're in the low 20% of our revenue comes from international customers, and part of our margin improvement strategy is to grow our international business. And just as a reminder, about half of that is foreign military sales, which has margins consistent with the DoD work for the most part, and the other half is direct commercial sale. And that's where we tend to have the higher margins. But as Ken said, more international is synonymous with higher margins, and that's where our focus is. These supplementals are a big step in the right direction.

Operator

Our next question is from the line of Gautam Khanna with TD Cowen.

Gautam J. Khanna - *TD Cowen, Research Division - MD & Senior Analyst*

Can you hear me, guys?

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

Yes, we can.

Gautam J. Khanna - *TD Cowen, Research Division - MD & Senior Analyst*

Terrific. I just had 2 quick questions. First, I was wondering if you could give us more granularity on the RF tactical backlog book-to-build trends. You mentioned something on SOCOM. And if you could just talk a little bit about overall mix this year and perhaps next in that business? And then I had a question on IMS EACs and if those have turned positive? And if not, what sort of still holding that segment back with respect to kind of the profit accruals?

Kenneth L. Bedingfield - *L3Harris Technologies, Inc. - Senior VP & CFO*

Yes. From a tactical radio perspective, I would say we're -- had a solid bookings order in the quarter. We've got a very solid backlog for that business at this point in time, looking at a multibillion dollar backlog in that business. And for a pretty quick turn, our shortest-cycle business, that is a very robust backlog at this point in time. So we're excited about the opportunities.

I would say the Marine Corps and SOCOM opportunity is a great one as we continue to expand that partnership with that very important customer for the business. We were also down-selected for the Air Force Next Gen Survival Radio, which is a great opportunity for that business to expand into a new market as well.

And then clearly, the supplemental as Chris mentioned, and the international opportunities, so I think a huge opportunity in terms of really strong backlog at the Tactical Communications business. And as Chris mentioned, a great business model that enables them to kind of turn that factory pretty quick to deliver the radios to appropriate customers as needed based on critical demand and critical needs on the battlefield.

At IMS, in terms of -- I think the question was about EACs. And I would say that as we talked about in the prepared remarks, every segment performed better from a net EAC perspective. IMS was a part of that, significantly better performance than Q1 '23. IMS is our longest-cycle business, and it takes a while to kind of turn those programs and the operations and get everything working through the system. I think IMS had great performance in the first quarter at 11.4%, working towards the guidance that we put out there for IMS for full year '24.

And strong performance on their programs, I think really starting to stabilize both the operations in terms of rates, realizing some of the benefits of LHX NeXt as well as all the hard work that the sectors within IMS segment are doing to deliver on their programs. So we're really excited about kind of the stabilization and the continued strong performance as we look out into the remaining quarters of '24.

Operator

Our next question is from the line of Richard Safran with Seaport Research Partners.

Richard Tobie Safran - *Seaport Research Partners - Senior Analyst* more times than not, it's a bad contracting vehicle. Nobody is perfect, and there are performance issues, but you cannot perform of a bad contract. And that's what we're trying to do, I guess, on next opportunities to prime.

I mean we have -- and again, we take an approach where is the best approach, either be a merchant supplier or a subcontractor or a prime based on our capabilities and what the customer needs.

There was an Armed Overwatch. We've been successful there. We just got the delivery order 3. So we're up to 25 aircraft already. HADES, which is a big opportunity for the Army. It's the High Accuracy Detection and Exploitation System. It's basically up to 14 aircraft. We're bidding a global 6,500. This aligns clearly with our ISR and other capabilities. So that would be a big win for us. We have some maritime, undersea ranges where we've primed, and there's some follow-on opportunities, a bunch in classified space. I usually get a space question for now, but I'll just plug that we had no satellites in orbit at the date of merger.

We launched 6 in the quarter, and we've been awarded 60 SATS as prime, and there's more in the pipeline. So those come to mind just off the top of my head. And of course, we have a lot of opportunities at Aerojet Rocketdyne. And those are follow-on, but those are not prime programs. So I guess, SDA. I was thinking SDA Tranche 3 for tracking. As you know, we're the only company to have been awarded Tranche 0, 1 and 2 for a total of 38 satellites. We should get an RFP in the fourth quarter for Tranche 3, and that could be another 18 satellites. So hope that helps, Richard.

Operator

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

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

I wanted to ask about the performance in the quarter. I think well above your full year guidance. So how are you thinking about that? And then if you could just touch on 2 programs out there in the press a lot where you're a supplier, F-35 Tier 3. And then how you're (inaudible) those.

Kenneth L. Bedingfield - *L3Harris Technologies, Inc. - Senior VP & CFO*

Yes. Thanks for the question, David. Appreciate it. I think you were breaking up a little bit, but I believe the question was about SAS performance in the quarter. And solid performance by the SAS team in the first quarter, 12.3% margin rate. And they are performing well on their programs. We talked a little bit about some of the drivers there, including maturing some of the development programs. And we also talked a little bit about the mix. And as space continues to grow, that's a little more cost-plus mix. That could temper a little bit of the margins in the last 3 quarters of the year.

But we did update guidance for SAS to approximately 12% on the margin rate. They were 12.3% in the first quarter, some upside from EAC adjustments. And as we saw strong program performance, you've got to kind of book that in the quarter.

You do -- it does result in a higher booking rate as you move forward, but you do pick up some cume catch adjustment that flows through in that 90-day period versus the full year impact where that gets tempered a little bit. But we're very confident in the team at SAS, and we're confident in the guide that we put out there for approximately 12%. And I know the SAS team is out there working hard as we speak to try to figure out how to drive that up from there.

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

And I think second part of your question was F-35. Our production deliveries are tracking. We have a ramp coming up in production here starting next month. So we continue to have good relations with Lockheed. In fact, I was just talking to them yesterday. They'll be starting to deliver aircraft, as you know. They'll comment on that themselves. But as they start delivering aircraft, we're going to have to ramp up even further and quicker.

And that's our plan. We've made the investments in most of the infrastructure we need. So continued improvement month-over-month, quarter-over-quarter. And it's all about the core processor, and that's where the focus of the team is.

Operator

Our next question is from the line of Matt Akers with Wells Fargo.

Matthew Carl Akers - *Wells Fargo Securities, LLC, Research Division - Senior Equity Analyst*

Chris, I wonder if you could comment on the international pipeline at IMS in particular. You mentioned the award in the quarter, but just curious if orders are kind of starting to move there.

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

potential share gains and investment? What it means for the revenue top line outlook over the next few years? I know you laid out mid-single-digit targets, but how do we think about your revenue growth and market share gains?

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

Yes. Thanks, Sheila. We're being selective in where we invest and bid. And if I look at the different domains, I think space is a perfect example where we are absolutely taking a market share. And as I said earlier, we've been awarded 60 satellites as a prime just since the merger, including 38 for SDA tracking alone.

And there's -- it's a hot market. But every couple of weeks or months, you can pick up a paper and see there's one less company in this market, a lot of [SPACs]. A lot of companies are withdrawing from that market. And we take that as a sign of our success. We're making money and we've disrupted the market. So I feel really good about what we've done in space.

The airborne domain, I think it's really going to be more with -- what I referenced with the business jets. Maybe Armed Overwatch, to a lesser degree, where again, we're filling in gaps and replacing long-term incumbents are giving them different platforms, with better capability for the missions that they want.

Our maritime work on the undersea ranges is world-class. Again, you go back 6 years, we had no work in that regard, and we found an opportunity to unseat a long-term 40-year incumbent and came up with a different solution. And it's been well received around the globe, as an example.

We've talked historically about our torpedo launch and recovery system using unmanned undersea vehicles. That market is a hot market, in my opinion. We just have to get out there and get a couple of customers, and I think that could be a real game changer for our undersea business.

On the radios. We talk about the radios, a lot of good work there. An exciting one that we haven't really talked much about is for the Air Force, which is the Next Gen Survival Radio. So we're 1 of 2 companies competing on that. And in a couple of years, we could be down-selected a new market. And another example, dislodging a long-term incumbent.

And then, of course, innovation in cyber. There's something going on there every day, and you kind of have to innovate daily to stay ahead of the threat. And we're doing that and seeing good growth and good performance in that domain as well. So I hope that answers your question.

Operator

Our last question is from Doug Harned with Bernstein.

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

Chris, when -- I mean, right now, you're looking at Aerojet Rocketdyne, and demand in that market is just getting better and better. And you talked a little bit about the NGI win earlier. But when you look at the demand there, and I think back to -- I remember a year ago talking with you about the situation at Aerojet Rocketdyne, Camden, for example, and how serious the bottlenecks were in trying to get production up?

So when you look at the business now, can you see the potential to ramp up? Can you talk about what kind of growth you could potentially get from that business? And then where you stand in the process of being able to get those bottlenecks out and really move production higher?

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

Yes. Doug, great, great question. And yes, it was about 16 months ago when we announced this acquisition. And I think I agree with you. When I look at where we are now, the business case gets better and better. The demand, there was no conflict in Israel. People thought Ukraine would be done. Nobody anticipated a $900 billion of defense spending for 2024.

So the tactical missiles, the nuclear deterrent, NGI, just tons of opportunities on SRMs. Over the long term, call it 5, 7 years, double-digit growth on the top line does not seem unreasonable to me. We have to, of course, invest in the capacity. The bottlenecks, some of them are based on low yields and performance and supply chain. I think we've made good progress in that regard, investing in our suppliers, getting additional suppliers.

I continue to think the more money the government can give to the supply chain, the better off we are. I continue to believe we don't need an additional solid rocket motor prime. What we need is someone working on the igniters, the nozzles and the cases. And I think that would help unlock the potential.

We've ordered equipment to continue to expand, whether it's mixers, ovens. They, unfortunately, tend to have a 50-, 60-week lead time, but we've placed those orders. And once we get that in, I think it's going to be -- help with the ramp. We have DPA money to build some buildings, take existing facilities and modify them. So the consolidation and piece dividend and Budget Control Act for a decade kind of stifle the ability for companies to invest and grow and inconsistent demand signals.

But right now, I think everything is a potential tailwind. And we'll have the factories digitized by the end of this year, and we're making the investments and fixing the processes. So pretty excited about it. And 2024 is kind of catch up and continue to burn down the delinquent backlog and simultaneously invest and put in processes. But I think by the time we get to 2026, 2027, if all stays as is, it's going to really turn out to be a great acquisition.

So I appreciate the question, Doug. And let me just wrap it up. And first of all, thank the workforce and the leadership team for a great first quarter. Obviously, thank you all for joining the call today. And Ken, Mark, myself and the team will be engaging with many of you in person in the months to come.

So thank you all, and have a great weekend.

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.
