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# EDITED TRANSCRIPT

## LHX.N - Q2 2024 L3Harris Technologies Inc Earnings Call

EVENT DATE/TIME: JULY 26, 2024 / 12:30PM GMT

OVERVIEW:

Company Summary

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.

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.

## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions) Peter Arment, Baird.

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

**Operator**

Robert Stallard, Vertical Research Partners.

**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?

**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.

**Operator**

Ron Epstein, Bank of America.

**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?

**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 fng toahead.

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 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 embr ayd ac embrsthe tea3 la5really 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

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.

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 facilitization, 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 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.

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

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.

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

Rob, let's take our last question.

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**Operator**

Gavin Parsons, UBS.

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**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?

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**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.

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**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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