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HRS - Q2 2014 Harris Earnings Conference Call

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OVERVIEW:

HRS reported 2Q14 EPS of $1.27. Expects 2014 revenue to decline 1-3% and EPS to be $4.80-4.90.

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CORPORATE PARTICIPANTS

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Bill Loomis *Stifel Nicolaus - Analyst*

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PRESENTATION

Operator

Good day, ladies and gentlemen. Welcome to the Harris Corporation second quarter 2014 earnings conference call. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session and instructions will follow at that time.

(Operator Instructions)

As a reminder, this call is being recorded. I would now like to turn the conference over to Pamela Padgett, Vice President of Investor Relations. Ma'am, you may begin.

Pamela Padgett - *Harris Corporation - VP of IR*

Thank you. Good morning, everyone. Welcome to our second quarter FY14 earnings call. I'm Pamela Padgett and on the call today is Bill Brown, President and CEO; Gary McArthur, Senior Vice President and Chief Financial Officer.

Before we get started, a few words on forward-looking statements. In the course of this teleconference, management may make forward-looking statements. Forward-looking statements involve assumptions, risks, and uncertainties that could cause actual results to differ materially from those statements. For more information and a discussion of such assumptions, risks, and uncertainties, please see the press release and filings made by Harris with the SEC.

In addition, in our press release and on this teleconference, and the related presentation, we will discuss certain financial measures and information that are non-GAAP financial measures. A reconciliation to the comparable GAAP measures is included in the tables of our press release and on Investor Relations section of our website, which is www.harris.com. A replay of the call will also be available on the Investor Relations section of our website and with that, Bill, I'll turn the call to you.

Bill Brown - *Harris Corporation - President and CEO*

Okay, well, thank you, Pam and good morning, everyone. Second quarter results were solid with earnings per share and orders above prior year. Our focus on cost savings continues to drive good performance in a tough US government market. The international orders and revenue are both particularly strong, highlighting significant progress in our strategy to expand outside the US.

Now turning to slides 3 and 4 of the presentation, earnings per share was $1.27, up 2% on revenue down 5%. Good program execution as well as Company-wide operational excellence initiatives, including the benefit of prior year restructuring actions drove operating margin for the Company 50 basis points higher year over year and up in each segment.

Orders were up 8%, driven in large part by a 35% increase in Tactical Communications on strength in the international market. Orders were also higher in CapRock's Energy and Maritime markets well as in IT Services. Book-to-bill was 1.2 for the Company and we ended the quarter with a funded backlog of $3.4 billion up, both year over year and sequentially.

As we mentioned in the call last time, our international tactical radio pipeline was firming up and in the quarter, we booked a number of significant international orders across a broad customer base, including: $100 million from Australia, $49 million from a country in the Middle East, $36 million and $21 million from two NATO countries, and $28 million from a country in Latin America, all of which are multi-year programs and carry additional follow-on opportunities, both within the 12 to 18 month pipeline and beyond. Now, typically once we become a tactical radio supplier of choice in the country, additional follow-on opportunities tend to flow to Harris. Australia is a great example.

Our relationship with Australia goes back decades, and orders to date have now exceeded $0.5 billion, including the recent $100 million order for Phase III of their modernization program. And we still see significant opportunity ahead of us. Even after strong bookings in the quarter, our international tactical pipeline remains robust at $2.2 billion, with other significant opportunities that we discussed before, such as Iraq and two countries in central Asia, making good progress through the procurement process and moving closer to award.

On the US DoD side, Tactical Radio revenue was weaker in the quarter, as expected, due to budget constraints and as customers operated under a [CR]. But we also had some good news with the US Army officially changing its procurement strategy for the JTRS Manpack and Rifleman Radio programs to full and open competition and a multi-vendor award.

The Army's tactical radio modernization remains a tremendous multi-billion dollar opportunity for Harris and we're also encouraged that the Army's plans are well-funded in the budget. We believe our unique commercial model, which drives speed and innovation and the scale advantage provided by our extensive international presence, will continue to make us highly competitive in all the Army's procurements.

In our INS segment, as mentioned in our last call, we've booked a five-year contract with Carnival for broadband data and communication services across their fleet of 103 ships. This is a big win and following closely on the heels of an earlier win with Royal Caribbean gives us more than 1/3 of the global passenger cruise market. And as we've seen with Royal Caribbean, that unprecedented bandwidth we're delivering to a cruise ship is causing cruise operators to rethink the services they can provide to improve passenger experience and crew morale, driving bandwidth demand far higher than anticipated in the base contract. This is a real positive development for our growing cruise business.

Now before turning it over to Gary to discuss segment financial results, let me make a few comments on the recent budget deal. First of all, it mitigates a sequester burden and is a good first step towards more certainty in the government market. And at the funding [line] level, we saw no big surprises.

Our major programs within government communications are well-supported, including all three FAA programs: FTI, NextGen DataComm and NextGen Voice Switching are classified programs as well as [AIP] F-35 and F-18. In tactical radios, the typical visible spending lines are about what we had expected. The MNVR and HMS budgets were well-funded at a level to support upcoming procurements. There was no cut to SOCOM, and in Navy, the Marine Corps and the Air Force took a little haircut from the President's budget request but were in line with what we had planned.

Foreign military funding is up about 3% versus overall versus the prior year and at the country level, our international FMF opportunities are well-supported. Of course, we need to see how the funding flows down to individual programs, but overall, from what we've seen so far, these are positive signs.

So as we look ahead, we have a little more budget certainty, more traction in the international markets and we continue to ramp up our operational excellence initiatives to reduce cost while funding investment in R&D and sales and marketing, all of which have increased our confidence and led towards raising our FY14 earning guidance. And now I'll turn it over to Gary to comment on segment results and guidance for 2014. Gary?

Gary McArthur - *Harris Corporation - SVP and CFO*

Thank you, Bill, and good morning, everyone. Moving to segment results on slide 5, RF Communication orders were $512 million compared to $402 million in the prior year, and up 27%. Revenue was $455 million, down 6% from prior year of $486 million. Book-to-bill was 1.13.

In Tactical Communications, orders were $387 million, up 35% while revenue was $320 million, declining 5%. Both orders and revenue in the US were weak, as anticipated, while international revenue and orders were strong. Book-to-bill for Tactical was 1.21 and funded backlog increased sequentially from first quarter $664 million to $730 million. Compared to this time last year, backlog is up 30% and trending positive.

Public Safety revenue in the quarter was $135 million, declining 9% due to continued weakness across system and terminal sales in the state and local markets. Public Safety orders were $125 million, up 8%. While orders have picked up and are up 10% in the first half, they will not turn into revenue fast enough to drive revenue growth in the year.

We now expect revenue to decline mid- to high single digits for the full fiscal year. The weakness is at least partially due to the market, which was up 8% in calendar 2012 when our revenue grew 12%; it was about flat in calendar 2013 with our revenue falling 7%. We've responded by adding resources to drive growth, including: investing in sales, marketing and new product development. And we expect topline recovery to begin next fiscal year.

Operating income for the RF Communication segment was $142 million, with a 31.3% operating margin in the quarter compared to prior year's 31.1%. For the full year in RF Communications, we still expect flat revenue. However, we now expect Tactical Communications revenue will be up low single digits, driven by stronger international growth, offset by revenue decline in Public Safety, and we still expect an operating margin of about 30% for the year.

Turning now to slide 6 and the Integrated Network Solutions. Second-quarter revenue decreased 9% to $366 million. Revenue growth in CapRock's Energy and Maritime markets and flat revenue in IT Services was more than offset by lower government revenue in both CapRock and Healthcare. The government market for both of these businesses has been more challenging than expected, with tighter funding and increased competition.

Segment orders were up year over year and more higher than revenue due to strength in IT Services and in CapRock's Energy and Maritime markets. CapRock also received a $75 million follow-on order from DISA to provide end-to-end managed terrestrial network services.

IT Services orders included $61 million from the US Navy to extend continuity of services on the Navy/Marine Corps Intranet Program through the end of our fiscal year, And a $53 million follow-on order to operate and support the US Air Force Space Command's 50th Space Wing. IT Services also was awarded a position on the six-year, multi-vendor NETCENTS-2 Product IDIQ contract from the US Air Force with a $6.9 billion ceiling value.

Integrated Network Solutions segment operating income was $33 million, flat compared with the prior year. Operating margin was 8.9% and improved, compared to 8.2% in the prior year, as cost savings initiatives offset the impact of lower revenue and margin pressure from a very competitive government market environment.

Looking ahead to the full fiscal year for the segment, we now expect the strength in CapRock's commercial business, which is trending towards double-digit growth, will be more than offset by a weaker-than-expected government market in CapRock and Healthcare, and a slower revenue ramp in commercial healthcare. Revenue for the segment is now expected to be down 5% to 6% and operating margin to be in the range of 8% to 9%.

Moving to slide 7, Revenue and Government Communications was $433 million, increasing 1% from the prior year, and higher in all three customer areas: civil, classified, and for the first time in nine quarters, defense. Major drivers include: a higher revenue from classified and space customers, the ramp-up of FAA's NextGen DataComm program, and the start of full-rate production on the Army's MET SATCOM Terminal program, all of which was partially offset by lower revenue from NOAA's GOES-R Weather program.

In the quarter, Harris received orders of $46 million from the FAA for the NextGen DataComm program and $31 million for avionics infrastructure for the F-35 program as well as awards totaling $121 million from classified customers.

Operating income was $66 million and operating margin was strong at 15.4% as a result of good program performance. For the year, we now expect Government Communications revenue to be stronger than previously anticipated, and have increased guidance from a range of down 5% to 7% to now down 1% to 3%. We also expect a stronger operating margin of closer to 15%.

Turning to slide 8, free cash flow was $55 million versus $120 million last year and capital expenditures were $52 million compared to $39 million in the prior year. Free cash flow was negatively impacted by a [billing] rate dispute with the US government which is close to be resolved and tactical orders booking late in the quarter.

We continue to expect free cash flow for the year to be equal to or higher than net income. During the quarter, we repurchased about 787,000 shares for a total cash outlay of $50 million, bringing first half repurchases to $150 million. We now expect full-year repurchases of $300 million versus prior guidance of $200 million. Our effective tax rate for the quarter was 32.6% and we still expect about 33% for the full fiscal year.

Moving to slide 9, FY14 EPS guidance has been increased from a range of $4.65 to $4.85 to a range of $4.80 to $4.90. Revenue guidance remains unchanged, with an expected decline of 1% to 3%.

With that, let me turn it back to you, Bill.

Bill Brown - *Harris Corporation - President and CEO*

Okay, well, thank you, Gary. On these calls, I try to report the good with the bad and this quarter is no exception. Overall, we had a balanced quarter with solid earnings, encouraging orders and increasing backlog with a number of positives, including: international strength, stronger revenue in Government Communications, IT Services performing well in a tough market and commercial CapRock gaining momentum.

But as Gary pointed out, there are pressure areas as well: performance in Public Safety, Healthcare not maturing quickly enough, and a more challenging CapRock government market. I can assure you that all of these areas are getting a lot of attention from senior management. I know we have a lot of work to do. We're going to stay focused on it until we can demonstrate sustainably better results.

So, with that, I'd like to ask the operator to open the lines for questions.

QUESTIONS AND ANSWERS

Operator

Thank you.

(Operator Instructions)

Carter Copeland, Barclays.

Carter Copeland - *Barclays Capital - Analyst*

Just a couple of quick ones. On the PSPC weakness, I wondered if you might just give us a little more color and help understand what's going on there? You mentioned timing of contracts but then also mentioned investments in new products.

I wonder, is this more of a tighter competitive environment or is it more of a timing-related end market customer effect? Anything you can do to help us understand that better?

Bill Brown - *Harris Corporation - President and CEO*

Yes, Carter. I think it's a combination of both things. As Gary mentioned, it's -- we do see as [partly] the market. The market was pretty strong in CY 2012, calendar 2012, and we were up above the markets. We had gained a bit of share that reversed itself in calendar 2013 when the market was more flattish and we were down 7%, including down about 11% in our first half of our fiscal year so, part of it is the market.

As I said on this call last number of quarters, about 8 of our last 10 quarters, we had book-to-bill less than 1. And although we saw orders grow year over year in the first half, in fact, up about 12% Q1, 7%-ish in Q2, it's mostly in our Programs business and that adds to backlog, which is positive for us but the revenue impact from that is likely to move out of our fiscal year into FY15.

As I said last time, I think we're really doing all the right things to grow our business. We are investing in sales and marketing; we're adding salespeople to drive Terminals, our Terminals business to capture large systems to work to convert some of the old analog systems to P25, including our own EDACS System. So we're adding sales and marketing resources and that does take time to return. We're also investing in new product development to add features, to expand our offering, and to reduce the cost of our product offering, and again, that also is adding cost and will pay back, we believe, over time.

I think as I step back, I think the backlog remains pretty solid. It's about $600 million, which is pretty much in line with where we were in FY13 sales. So at least going backwards, it's about all of our 2013 sales in backlog today. The opportunity pipeline is pretty good it's pretty healthy.

We do think the market is going to return to its historic growth rate of a 3% to 5% range over time. And we think with the investments that we're making and the organizational model put into place, we think business could be a nice-growth business for us. Those are all the effects that are happening right now. We just don't see it returning in the back half of our fiscal year.

Carter Copeland - *Barclays Capital - Analyst*

Okay, great. And with respect to the RF guidance. Obviously, you would assume there was a positive mix benefit with the Tactical versus PSPC shift in the revenues? But the margin guidance didn't change, is that -- it just wasn't material enough to change it or is there anything we're missing there?

Bill Brown - *Harris Corporation - President and CEO*

No. That would naturally drive you to that conclusion. We do see some mix shifts in the back half. We saw a bigger international orders in the quarter, which will turn into revenue in the back half and the international business, especially with the systems and the product mix that we're seeing there, comes in at slightly lower margins than we have typically seen in the past. I think the bigger factor is that, in December, an official Army notification came out that opened up to full competition and multi-vendor, the HMS program and we purposely held back investment on that until that officially came out.

We now will stamp up -- step up substantially in the back half on R&D investment. We're in the business and we think we're going to be very competitive, and we're going to invest to be competitive. So I think it's more of the factor of the investment we see coming in, in the back half in [IRAD].

Operator

Yair Reiner, Oppenheimer.

Yair Reiner - *Oppenheimer & Co. - Analyst*

Question about INS. The reduction in revenue outlook there was a fairly dramatic, I guess fortunately offset by government systems -- by government communications. Can you step through the elements of that reduction for the year?

Gary McArthur - *Harris Corporation - SVP and CFO*

Sure, let me touch on that. What we're really seeing is further weakness in the government areas of CapRock and in Healthcare be more severe than expected. As we talked about in my remarks, competitive pressures are higher than we thought they would be. I think the government reduction in spending in these areas has only increased that.

Now we've taken steps that we think will make us more cost competitive in the back half, but we do see that, that part of the business is going to more than offset what we expect to have as double digit growth in the CapRock Energy and Maritime businesses. And HITS doing a little bit better than the 10% down we said in the first half. We think it will be now kind of low-single digits down in the second half, is why we came up with the guidance that we have just provided.

Yair Reiner - *Oppenheimer & Co. - Analyst*

Great. And then just one more. Your headquarter's expenses stepped down nicely in the quarter, and I just wanted to know whether the rate that we saw in 2Q is the right way to look at things going forward or whether there was anything that kept expenses unusually low in 2Q?

Bill Brown - *Harris Corporation - President and CEO*

We see quarter to quarter some variations, and if you go back in a number of quarters, you'll see some things moving around but, Yair, the long-term trend is -- has been to bring down our corporate expenses starting a couple of years ago based on where the market happens to be. So it's part of a trend but I wouldn't read too much into the quarter-to-quarter gyration.

Yair Reiner - *Oppenheimer & Co. - Analyst*

So for the full year, something in the low $60 millions is still the way to think about it?

Bill Brown - *Harris Corporation - President and CEO*

Yes, that's probably in the right ballpark.

Operator

Bill Loomis, Stifel.

Bill Loomis - *Stifel Nicolaus - Analyst*

Just staying with INS, a couple more questions on that. When -- on your commentary, you said CapRock commercial was trending towards double digit. Was it double-digit growth in the quarter? And it sounds like you certainly expect it in the second half. So what type of growth for the year are we seeing on CapRock commercial?

Bill Brown - *Harris Corporation - President and CEO*

We have very strong orders in the first half on the commercial side there, the revenue will follow that so the revenue growth -- revenue is positive growth; it wasn't double digit in the first half, and but we do see it getting but -- a bit stronger in the back half of the year on CapRock commercial.

Bill Loomis - *Stifel Nicolaus - Analyst*

Then on the commercial Healthcare, what's the update now on Carefx and how do you see that and even more importantly on the margin side, how has that been impacting margins? How is it factored in, in the second half?

Bill Brown - *Harris Corporation - President and CEO*

Bill, on the Healthcare business, about 7% of our business in Healthcare is with the US government. And I think we mentioned last time, we lost a lot of recompetes at DVA where the market has shifted from development to sustainment that requires a lower cost structure. We're leveraging what we have on our HITS business, which is very low cost structure, low wrap rate to improve our competitiveness on the government side, but I don't see that coming back in here. So that's from the government side of Healthcare.

On the commercial side, it's about 30% of a relatively small healthcare business is commercial, so reading into that, about $30 million to $40 million in revenue. We are seeing a slower ramp of our clinical integration software. We are installing it in four different customers in North America; we have a pilot going on in the UK with a partner in British Telecom. It's not a shrink wrap-type installation; it requires several months to connect all the departments, the clinics, the hospitals in the network. We are at the beginning stages of the rollout; it's too early to call success but just -- I mean, keep in mind, it's a relatively small part of the overall Company.

On the margin side, if you go back, and I'm talking about Healthcare overall because it's the broader entity. We had a pretty big loss in FY12; it was in the $18 million range. We reduced it last year to about $7 million. We've seen some contract losses again this year in DVA, the spend for software development on the commercial side, which had moved towards expense from being capitalized. It's also causing us some losses in the FY14 area, and it's undermining our progress. We lost about $8 million in the first half of the year in Healthcare as a whole. We took a lot of actions in the second quarter, which we think will improve our second half results. But clearly, we need to see a customer ramp up and higher revenues to drive us to being profitable in the Healthcare business.

Operator

Joe Nadol, JPMorgan.

Joe Nadol - *JPMorgan Chase & Co. - Analyst*

Bill, you highlighted several times the international strength in RF and I was wondering if you'd be willing to share what percentage of your Tactical Communication revenue this year you think now will be international or maybe a percentage of the backlog or some such metric?

Bill Brown - *Harris Corporation - President and CEO*

I'm not sure we'll get into the backlog, but I think we said we've seen a trend moving from international being less than DoD in the past, especially when we had a pretty big ramp-up in FY10, 2011. To now, international is higher than DoD. And I know Pam is going to cringe but it's probably in the 60/40 range international to DoD this year on a revenue basis.

Joe Nadol - *JPMorgan Chase & Co. - Analyst*

Okay. That's helpful. And then could you provide your -- you gave us your pipeline for international; could you give us that for domestic? And then also for Public Safety?

Bill Brown - *Harris Corporation - President and CEO*

I'll ask maybe Gary on the Public Safety side. On the DoD side, our pipeline, 12- to 18-month pipeline is now about $900 million. You may recall we had $1.1 billion in the last call. About $350 million of the $900 million is in pretty advanced stages of closure. It's in proposal enclosure phases.

Mostly supported by FY13 and FY14 funding lines plus we've already said some not so visible lines. About 55% of that backlog of the pipeline rather at $900 million is Air Force, it's the Marine Corps, it's SOCOM, it's all the Modernization activities there, all of which are standardizing on the Falcon III. About 10% of our pipeline is Army BCT Modernization.

Last time that was 25% so about $250 million or so, so that's -- today it's 10% of the $900 million, so we've backed out based on what we're seeing on those big [MH-HMS] programs from our pipeline because that's moving out to the right. And the other 10% is other Army -- there's a 10% or so with spares and services, a few other percentages that are more in specialized-type products: ISRs, tablets and other things. But it's $900 million today for DoD.

Joe Nadol - *JPMorgan Chase & Co. - Analyst*

And then just on the Public Safety side?

Gary McArthur - *Harris Corporation - SVP and CFO*

On the Public Safety side, Joe, the pipeline is pretty healthy at $2.4 billion. And looking at the make-up of the pipeline, there's a lot of different opportunities across the board in the state and local. It really isn't the pipeline. It's the issue -- it's projects moving to the right and our win rate isn't where it needs to be; it's the key areas we've got to improve on.

Joe Nadol - *JPMorgan Chase & Co. - Analyst*

Okay. And then just one more quick one. Bill, you've upped your share purchase guidance for the year by $100 million. How are you thinking, a little bit more broadly speaking, looking forward, not just for this year but into next year, about cash deployments, dividend, repurchase and M&A?

Bill Brown - *Harris Corporation - President and CEO*

Well, if we look on this on a long-term basis, nothing that we see today with current advantage changing our strategy on capital deployment, we remain committed to returning cash to shareholders in a smart, efficient way. If you remember, or go back the last three years, we've returned in the form of share repurchases and dividends about 90% of our free cash flow.

We continue a targeted dividend payout ratio of about 30%. As Gary mentioned, we now expect about $300 million a share in our share buyback. Again, Joe, you remember going back a couple of years, we've really have focused on free cash flow. It's now become part of our executive incentive compensation metrics. We're confident about achieving our full-year target of about 100% of net income.

We are fully funding all of our internal needs. We don't see any significant M&A in the near-term horizon. We have no debt that's due until the 2017 time period. We're pretty comfortable with $300 million or so of cash on our books, which we typically carry towards the end of the year. And as you read into all that math, it leaves us with some excess cash, some of which we've now chosen to return to shareholders in a step-up in our buyback in the second half. So that philosophy, that approach, that focus on free cash generation, I don't expect is going to change going forward anytime soon.

Operator

Noah Poponak, Goldman Sachs.

Noah Poponak - *Goldman Sachs - Analyst*

I wondered if you could go back to the announcement of JTRS HMS moving to multi vendor? Is there anything you can share with us from a timeline perspective, in terms of what you may expect or what we can look for on milestones along the way with competition and [shipment] awards?

Bill Brown - *Harris Corporation - President and CEO*

Noah, there was an Industry Day back in December and there was some light shed on how the program is now expected to rollout. Overall, we're seeing about a six- to seven-month delay from what we had previously communicated. It's primarily due to the change in acquisition strategy, which we view as a positive. We now see for the Rifleman Radio Program of HMS, we see the RFP coming out probably in the next month or so. We heard January, February of 2014, so in the next month with an award, probably at the end of this calendar year, it says in the documents Q1 FY15 so I'd read into that December of this year, with the shipment in -- first shipment starting in March of 2015.

For the Manpack, we expect the RFP to come out sometime around April of this year, so couple months later. The award in Q2 of FY15, so again, I read into that about March of calendar 2015, with a shipment that's starting around April of 2015, all of which are in support of the NIE of 16.1 and the fielding for it to really set 2016. So when you look at the numbers and where the movement is, we did pull this out of our 12- to 18-month pipeline, as I mentioned in -- to Joe's question. It did results in relatively limited sales for us at Harris Corporation of FY15, more of a ramp in that business more starting in FY16.

Noah Poponak - *Goldman Sachs - Analyst*

Okay, that's very helpful. And then, Bill, I also wanted to ask you, with the momentum you seem to be experiencing internationally, I'm curious, is there something that's changed in the last three to six months about the total, broader US contractor selling internationally process? Or is this more Harris Company specific stepping up the effort there?

Bill Brown - *Harris Corporation - President and CEO*

I guess from -- I do see a lot of our peer companies stepping up their efforts to sell internationally, and you hear that in a lot of the calls. I think for Harris, international has been a big focus for us over many years and we have an extremely well-established dealer base, especially on the tactical side.

And we saw the international revenue step back while the DoD was pushed pretty hard over the last five, six, seven years, with the wars in Iraq and Afghanistan. We are pushing international very heavily and have been since I came a couple of years ago. We stepped up our focus; we're driving very hard. We're putting resources in place. We recently announced the appointment of a new president of our Brazil operations and we're putting some resources there.

We're pushing hard in the Middle East; we see good growth in Asia. So I think some of it is just what a lot of our peers are trying to do. I do think we have somewhat of an advantage because we have a very well-established base and we're driving it very hard. So, our numbers, if you go back to FY10, our revenue coming from international sources, as a percent of the total, was around 10%. Last year, it was around 26% and this year, we expect it to be in the 29%-plus range so I think overall pretty good results.

Noah Poponak - *Goldman Sachs - Analyst*

Okay. Just one other quick one, the CapEx number stepped up pretty noticeably in the quarter, which it doesn't usually do seasonally. What drove that and what does that do in the back half?

Bill Brown - *Harris Corporation - President and CEO*

We'll see this year capital spending to be up over last year and it's really just a couple of things. One is, we've got a building we're constructing for the GCS business in Palm Bay, a new engineering facility which we started a number of years ago and we're -- we expect to complete that by the end of this year or early calendar 2015. And then a pretty big software investment upgrade at RF Communications. So those are the two biggest events and that will drive our capital spending up as a whole this year for Harris.

Noah Poponak - *Goldman Sachs - Analyst*

Have you quantified that for the year?

Bill Brown - *Harris Corporation - President and CEO*

Yes, I'd say year over year, it will be up about $70 million just in those two areas -- $50 million up this year in the building and about $20 million higher year over year for the software. And total CapEx, I think we report in the Q and it's -- we're expecting around $250 million for capital expenditures this year.

Operator

Gautam Khanna, Cowen.

Gautam Khanna - *Cowen and Company - Analyst*

Hoping you could comment on the $2.2 billion foreign pipeline and maybe just articulate how that looks over the next six months versus over the balance of the 12- to 18-month period?

Bill Brown - *Harris Corporation - President and CEO*

That's a good question, Gautam. I'm not sure that I could make six months; I think that's cutting a little bit tighter than we want but I am happy to comment on the shape of the pipeline. And then you can read into what you wish but as we mentioned, it's about $2.2 billion. It's about the same as the first quarter and we have about $600 million that are in the proposal enclosure phase. So I guess you could read that, that is more near-term in the balance of the pipeline, that -- it is very healthy. It continues to firm; we feel pretty good about that.

As I said last time, more than half of it comes out of the Middle East and Asia. We know that Iraq is a big part of our pipeline; there's a country in Africa. We see several other countries in the Middle East, a couple countries in central Asia, all are in that category that gives us confidence that more than half of it is coming from the Middle East and Asia.

When you see about 15% or so coming from coalition countries that are deploying wideband and you see that as some of the big order that came in Q2 in Australia, we see more opportunities over the next 12 to 18 months. Then you see Latin America firming up; that's about 15% to 20% of our pipeline. Brazil looks pretty good, Mexico looks pretty good, Colombia, a few other countries there are in that pipeline and the rest would be just a smaller group of smaller countries sprinkled in there. So, that sort of gives us some characterization of our overall pipeline. I wouldn't comment more than that on what the next six months may look like.

Gautam Khanna - *Cowen and Company - Analyst*

Fair enough. Within the Middle Eastern piece, which it seems like you have a concentration, is there -- are there any that stand out as particularly large awards and if you could just give us a sense for the size of those? Iraq, you've mentioned in the past but [anything else]?

Bill Brown - *Harris Corporation - President and CEO*

Yes, what we've talked about is Saudi's got a pretty big long-term pipeline. Certainly Iraq is pretty sizable. UAE is a good opportunity for us. Those are the -- I think those are the more significant ones. But there are opportunities going forward in, we believe, in Oman, and Yemen, and Jordan, and other places, but I think those are the biggest ones.

Gautam Khanna - *Cowen and Company - Analyst*

If you could just comment on HMS multi-vendor, how do you expect to -- how are you going to manage margins in that environment, because presumably it's, with multi-vendor, you're going to have kind of persistent price competition on the incremental orders. So if you could just walk through what you expect pricing to do over the next several years? And how you expect to manage the margins? Thanks.

Bill Brown - *Harris Corporation - President and CEO*

Well, Gautam, it's a very good question and I know it's on the minds of many people. The RFPs aren't out yet, so it's tough to comment on what the pricing is going to be or the pricing trends. But I would say, relative to that particular program that, and I alluded to this in my prepared remarks, we've got enormous scale in this business with a very large international tactical radio business. It's manufactured along the same lines that we manufacture our DoD business in one facility in Rochester, New York. So that gives us very big scale advantages and I think that could be brought to bear to be very price competitive where we need to be from a pricing perspective and yet still maintain strong margins in that business.

I also don't think it's necessarily, over time, going to be simply a price shoot-out on task orders because we will continue to invest, as we always do in driving innovation. And we will always invest to put more technology into the product and differentiate our solution and, hopefully, that will end up allowing us to preserve pricing and preserve margins in the business. So that's our expectation. But you should expect that, with the investments we're making in R&D in the back half, stepping up from the front that we're committed to the business and we're going to invest to win.

Gautam Khanna - *Cowen and Company - Analyst*

May I just ask another one then? You mention -- MNVR, you basically were the 100% share winner. On HMS, do you have a sense for where the government wants to go whether they want to split it 50/50 or among three suppliers or are they going to be comfortable awarding a large percentage of the requirement to one vendor while keeping --

Bill Brown - *Harris Corporation - President and CEO*

We really don't know, Gautam, at this point. In fact, we believe there's going to be multiple vendors, it's going to be at least two. It depends on what the part of the record does; is it going to be bidding as one or is it going to be bidding as two on the Manpack and the Rifleman? And it depends; so they bid as two and [ISOC] could be three awards. How the government decides to split up to is unknown to us.

We're confident that there's a long-term big opportunity based on the acquisition objective which, in the ADM that came out in December, didn't -- it was the same -- it was reemphasizing the same sets of numbers that we've seen in the past in terms of the Manpack. So we don't know how many bidders are going to be there, but we fully expect to be one, and we fully expect to win our fair share of the awards going forward.

Pamela Padgett - *Harris Corporation - VP of IR*

Operator, I think we have one more person in the queue?

Operator

Thank you. Josh Sullivan, Sterne Agee.

Josh Sullivan - *Sterne, Agee & Leach - Analyst*

On the energy side of CapRock, has the success been penetrating the existing rigs or moving on to these new larger, more sophisticated deepwater rigs?

Bill Brown - *Harris Corporation - President and CEO*

It's really both, actually. We are winning more content on existing rigs and we are finding ways of winning share in some of the new vessels that are being launched so it's really both of them, Josh.

Josh Sullivan - *Sterne, Agee & Leach - Analyst*

Okay. Then I guess just on the Carnival wins, what is the construct -- contract structure look like? Is it big upfront payment with a long tail of service?

Bill Brown - *Harris Corporation - President and CEO*

We're not going to get into the specific details of how the contract has been constructed. It is a five-year deal. We are preclude from talking about the amount of the deal. But similar to what we see elsewhere in CapRock, there is equipment installation upfront and the vendor is recurring revenue that comes back over time. And I don't think we'll talk more about the contract structure than that.

Pamela Padgett - *Harris Corporation - VP of IR*

Operator, I think we have one more person in queue?

Operator

Rich Valera, Needham and Company.

Rich Valera - *Needham & Company - Analyst*

Bill, in light of your comments that you see the HMS program mainly contributing revenue in FY16, anything you would say on FY15 expectations for the DoD tactical portion of the business in terms of growth?

Bill Brown - *Harris Corporation - President and CEO*

Well, I think it's too soon to talk about FY15. We just saw the -- some of the line item detail in the appropriations of FY14. We know that we have a topline number for DoD in FY15. We're four to six weeks away, I believe, from our President's budget coming out. That will give us, I think, a little more insight into his and the DoD's spending priorities on how they, how much they will plan to spend on for structure versus investment accounts and modernization. And once we know that, we'll know more about what the shape of 2015 looks like than we know today. So I wouldn't get out beyond talking about FY14 at this point. We'll share with you as we learn more about that budget and its implications for Harris going forward.

Pamela Padgett - *Harris Corporation - VP of IR*

All right. Thank you everyone for joining us today. Appreciate it.

Operator

Ladies and gentlemen, this concludes today's conference. Thank you for your participation and have a wonderful day.
