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HRS - Q4 2014 Harris Corp Earnings Call

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OVERVIEW:

HRS reported FY14 EPS of $5.00 and 4Q14 EPS of $1.28. Expects FY15 total Co. revenue to decline 1-3% and EPS to be $4.75-5.00.

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CORPORATE PARTICIPANTS

Pamela Padgett *Harris Corporation - VP of IR*

Bill Brown *Harris Corporation - Chairman & CEO*

Mick Lopez *Harris Corporation - SVP & CFO*

CONFERENCE CALL PARTICIPANTS

Omear Khalid *Goldman Sachs - Analyst*

Joe Nadol *JPMorgan Chase & Co. - Analyst*

Carter Copeland *Barclays Capital - Analyst*

Yair Reiner *Oppenheimer & Co. - Analyst*

Gautam Khanna *Cowen and Company - Analyst*

Chris Quilty *Raymond James & Associates - Analyst*

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Harris Corporation fourth-quarter 2014 earnings call.

(Operator Instructions)

As a reminder, today's 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, and welcome to our fourth-quarter FY14 earnings call. I'm Pamela Padgett and on the call today is Bill Brown, Chairman and CEO; Mick Lopez, Senior Vice President and Chief Financial Officer.

And 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, 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 measure is included in the tables of our press release and on the Investor Relations section of our website which is www.harris.com. A replay of this call will also be available on the Investor Relations section of our website. Bill, with that, I'll turn it to you.

Bill Brown - *Harris Corporation - Chairman & CEO*

Okay, good. Thank you, Pam, and good morning, everybody. Fourth-quarter revenue and earnings were solid and we generated significant free cash flow. For the full fiscal year, revenue and earnings per share came in at the high end of our guidance range, and free cash flow was excellent and exceeded our goal for the year. Our strategy to lower cost, invest in R&D to drive growth, maximize free cash flow, and return cash to shareholders is serving us well as we operate within what is still a constrained US Government spending environment.

Turning to slides 3 and 4 of the presentation, revenue was down 2% in the fourth quarter and the fiscal year. And although the government market is having an effect, particularly in our US tactical and IT services businesses, several growth areas with good momentum are minimizing the impact. International growth continues to be strong and was up 8% in the quarter and 13% for the year, driven largely by the tactical radio business, although our CapRock business is also contributing.

CapRock, which participates in the global maritime and energy markets, had revenue growth in all four quarters, excellent second-half orders, and a full-year book-to-bill greater than 1. As a percentage of total revenue, international increased from 26% in the prior year to now 30%.

And our Government Communications business is bucking the trend, with modest growth in both the quarter and full year, showing great resiliency. While the specific revenue drivers vary quarter to quarter for the segment, our strategy to grow the core by leveraging strong franchises to create new opportunities in the areas of space and intelligence, air traffic management, geospatial imagery, avionics, and weather is working well and is gaining momentum.

Turning to earnings, EPS was $1.28 in the fourth quarter and $5 for the fiscal year, 2% higher than prior-year non-GAAP EPS of $4.90. FY14 earnings benefited from more than $100 million in cost savings related to prior-year restructuring actions and ongoing operational excellence initiatives, with some of those savings funding investments for the future. Company-funded R&D was up 30% in the fourth quarter and 12% for the year, to 5.3% of total revenue, a level significantly higher than peer companies and which, when combined with the savings from OpEx initiatives, allows us to continue delivering innovative and affordable solutions.

Free cash flow was $334 million in the quarter and $648 million for the year, an excellent 120% of net income driven by very strong working capital performance. CapEx for the year $201 million, up $23 million from the prior year for investments in new systems and infrastructure to support growth.

We continue to return cash to shareholders with $300 million in share repurchases for the year, higher than the $200-million target we set at the beginning of FY14. And, during the year, we increased our dividend by 14%, 19% compounded annually over the last three years.

Orders in the quarter were about $1.1 billion, sequentially flat with the third quarter and down versus the strong prior-year quarter, with funded backlog declining 5% year over year. Book-to-bill for the year was just under 1 at 0.97.

Turning now to some segment highlights, in RF Communications, international tactical revenue was up 11% in the quarter and 25% for the year. And opportunities in the international tactical market remain relatively healthy. Our 12- to 18-month pipeline is $2.5 billion, up from last quarter's $2.3 billion, driven modestly higher by additional early-stage opportunities. We're also encouraged by the pipeline replenishing itself on the heels of 25% revenue growth and a number of large bookings in the year, including a $78-million fourth-quarter order from a country in Central Asia.

Opportunities with the Government of Iraq remain an important part of our pipeline and they continue to progress. We received the first $15-million order in Q4, and we have signed a contract on the next tranche and are working through the process of securing a letter of credit. Other significant opportunities that are looking strong and have grown a bit in the quarter include a few in Saudi Arabia, Brazil, Australia, the Philippines, and Mexico.

In the US, our tactical business was somewhat weaker than expected in the quarter. Our 12- to 18-month pipeline in the US remains in the $900 million to $1 billion range, but the velocity of opportunities moving through the pipeline is slow, with budget constraints delaying procurements. While we eliminated the JTRS HMS opportunity from our pipeline last quarter, there's been a lot happening recently regarding the JTRS procurement process and funding outlook that's worth spending a few minutes on.

The good news is that Undersecretary Kendall signed the new multi-vendor acquisition strategy for JTRS HMS, a significant milestone for Harris that allows us to compete for a multi-billion-dollar multi-year radio opportunity. A draft RFP for the Rifleman Radio was released, as well as draft technical requirements for the manpack. And the Army has now stated that the full-rate production will begin in GFY17. For Harris, this implies test units towards the end of our FY16, with the more significant revenue opportunity in FY17 -- about a year delay from what was previously anticipated.

This new schedule creates fielding gaps for future capability sets. And the good news for vendors like Harris is that the Army has said that there are no plans for another LRIP production order for the JTRS manpack. And, as a result, we believe this decision creates opportunities to fill the fielding gaps with Harris SRW Appliques, MNVR radios, and 117Gs, all of which support the JTRS waveforms.

Not surprisingly, the procurement delay is resulting in proposed GFY15 funding cuts and a reduction of prior-year funds. Based on recent information from the Appropriations Committees, unspent funds for JTRS HMS at the end of Government FY15 will be a bit less than previously anticipated, but still significant, at $200 million to $300 million. In terms of future funding, we're encouraged by the latest SAR, or selected acquisition report, that still shows Army radio modernization as a roughly 10-year, $5-billion market opportunity for Harris.

Clearly, the need for improved tactical communications remains one of the US military's highest priorities. And while the official JTRS HMS modernization program has pushed out, the Army's current and generation radios don't support networking with the high-speed data rates to deliver critical real-time information like situational awareness and video to war fighters operating in theater.

So we continue to invest to position us to be successful in any scenario as the US Army, other US services and international militaries modernize. In FY14, R&D spend was up 8% in RF Communications and 36% in the fourth quarter. Investments included incorporating the MUOS waveform into our products, as well as development of our multi-channel manpack radio, where we continue to make good progress.

In June, we received NSA certification for the manpack, a significant milestone needed for deliveries to begin. We anticipated the Army would be our first customer, but given procurement delays, the manpack will roll out first to other US customers, with our first order from the US Navy scheduled for delivery in October. Our tactical team has done an excellent job in designing this product, and we believe that, as it gets fielded, strong interest in the US and international markets will quickly build.

In Government Communications Systems, we had several significant wins to highlight, two of which were in the commercially hosted satellite payload market. In the fourth quarter, we booked a $63-million order for a new payload program on the Iridium NEXT constellation, the same platform that hosts the Aireon payload which put Harris at the forefront of this unique piggyback approach of using a commercially hosted payload to provide multiple missions on satellites.

Following the close of the quarter, we also received a five-year, $495-million multi-vendor IDIQ contract from the US Air Force for a hosted payload solutions program, which provides us a contract vehicle to pursue additional opportunities and further extend our leadership position.

Another strategic win in the quarter for Government Communications was from the National Geospatial-Intelligence agency for two, five-year single-award IDIQ contracts totaling $773 million for the Foundation GEOINT Content Management program. The awards cover two of three regions: $365 million for Region A that covers the US Pacific and Northern Commands; and $408 million for Region C that covers the US Africa and Southern Commands. With the award, we received an initial order in Region A, while Region C is currently under protest with resolution expected mid-September.

Now, this win is really important for Harris, and it builds off a 20-plus-year relationship with the NGA that's grown from trusted partner to now the leader in geospatial imagery. Dating back to 2000, Harris was 1 of 15 suppliers and, over time, became 1 of 6 -- and now 1 of 2 -- imagery suppliers to the NGA, with Harris providing two-thirds of NGA's global coverage. This program is expected to more than double our current geospatial revenue and create additional expansion opportunities in the US and abroad.

So, with that, I'll turn it over to Mick to comment on segment results and guidance for FY15, and then I'll come back with a few closing comments. Mick?

Mick Lopez - *Harris Corporation - SVP & CFO*

Thank you, Bill, and good morning to everyone. Moving to segment results on slide 5. RF Communications revenue was $493 million, down 1% compared to the prior year. Segment orders were $361 million, compared to $646 million last year.

In Tactical Communications, revenue was $348 million, up 4% over the prior year, with strong international revenue growth of 11% more than offsetting lower revenue in the US. The soft US market also dampened orders, which were $232 million in the quarter. This compares to prior-year orders of $498 million, which benefited from strong international bookings.

In Public Safety, revenue was $145 million, down 12% compared to $165 million in the prior year. Continuing weakness in the state and local market also impacted orders, which were $129 million, compared to $148 million in the prior year.

Operating income for the RF Communication segment was $141 million and operating margin was 28.5%, reflecting the planned increase in R&D spending. For the full year, operating margin was 30.7%.

Now, turning to Integrated Network Solutions segment on slide 6. Fourth-quarter revenue was $373 million, down 9% compared to the prior year. Revenue growth in commercial CapRock and commercial Healthcare was more than offset by continued US Government market weakness.

Segment operating income was $33 million, compared to non-GAAP operating income of $36 million in the prior year, primarily as a result of lower revenue volume. Operating margin was 8.7%, slightly higher than non-GAAP operating margin of 8.6% in the prior year, with improved operating performance in CapRock and Healthcare offset by lower operating margin in IT services.

We were encouraged by the progress made during the quarter in Healthcare, with the roll-out of our new vendor neutral suite of interoperability solutions called FusionFX. The number of live deployments grew from 29 to 45 hospitals, and we now have over 50,000 users on our systems.

Moving to slide 7. Revenue in Government Communications systems was $480 million, increasing 2% compared to the prior year. Higher revenue from classified customers, FAA's DataComm program, the F-35 program, and the US Navy's commercial broadband satellite program, were partially offset by lower revenue from NASA's Space Network Ground Segment Sustainment program and NOAA's GOES-R weather program. Segment operating income was $69 million and operating margin was 14.4% in the quarter and a strong 15.4% for the full year.

Turning to slide 8. The Company generated free cash flow of $334 million, compared to $273 million in the prior year. CapEx was $61 million, compared to $47 million last year. For the full year, free cash flow came in at a strong $648 million and operating cash was a record high, driven by a 12-day improvement in net working capital. In the quarter, we repurchased about 1.1 million shares for a total cash outlay of $86 million, and our effective tax rate was 32.3%.

Moving to slide 9 and FY15 guidance. In RF Communications, we expect revenue to be flat to down 3%, with continuing revenue growth in international tactical; a soft US tactical market due to slow government spending in the first half that should improve once the budget has passed; and about flat Public Safety revenue. Operating margin for the segment is expected to be consistent with this year, in a range of 30% to 31%.

In Integrated Network Solutions, revenue is expected to be down 7% to 8%, with solid revenue growth in CapRock and Healthcare more than offset by declining revenue in IT services due to the roll off of the NMCI contract and the decision to no longer sell low-margin pass-through products. Segment operating margin is expected to be in a range of 7% to 8%, with improved operating performance at CapRock and Healthcare more than offset by the roll off of the highly profitable NMCI contract.

Government Communications revenue is expected to be flat to up 2%. Expected revenue drivers in FY15 include classified programs, hosted payloads, geospatial, and a ramp up of F-35 production, and are providing good visibility for first-half growth. Segment operating margin is expected to be around 15% for the year.

We're expecting a 32.5% tax rate, which does not assume any benefit from an R&D tax credit. And corporate expense is expected to be about 5% lower for the year. For total Harris, revenue is expected to be down 1% to 3% and EPS in the range of $4.75 to $5, with a bit more pressure in the first half on a year-over-year basis than in the second half. Free cash flow is expected to be around 100% of net income, with CapEx of about $200 million. Our guidance reflects $200 million of share repurchases in the year. Now, back to you, Bill.

Bill Brown - *Harris Corporation - Chairman & CEO*

Okay. Well, thank you, Mick. As our FY15 guidance reflects, we're anticipating a similar constrained budget environment to what we experienced in our FY14 with the Government operating in the first part of GFY15 under a continuing resolution. Under a CR, our experience is that spending is generally slow, with new starts on hold as customers either don't spend or spend reluctantly until they have clarity for each specific budget line.

So, for Harris, we'll continue to make sure our cost structure reflects the current environment and that our organizational structure is optimized for success. And we'll stay the course with what's working in this environment: lowering costs, investing in technology and innovation to drive growth, maximizing free cash flow, and returning excess cash to our shareholders.

I'm really proud of what our teams have accomplished this past year, and we're committed to driving value for shareholders while meeting the needs of our customers for high-quality, innovative, and affordable solutions. And, with that, I'd like to ask the operator to open the line for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Noah Poponak, Goldman Sachs.

Omear Khalid - *Goldman Sachs - Analyst*

This is [Omear] filling in for Noah. Wanted to get your latest thoughts on capital deployment options here. And also, in particular, how are you guys thinking about the current portfolio after some of the initial actions that you took? And are you going to consider any potential M&A, whether it'd be a major event or a tuck-in here or there?

Bill Brown - *Harris Corporation - Chairman & CEO*

Well, I'm not going to comment today on any potential portfolio actions or M&A, but I would say that there's no recent event that's changing our strategy from the past on capital allocation. We remain committed to returning cash to shareholders in what we've always been doing is a smart and efficient way. If you look back over the last three years, we've returned close to 90% of our free cash flow to shareholders in the form of repurchases and dividends.

Our number-one priority has been, and will remain, funding internal requirements. And I think we've proven ourselves to be able to do that through capital spending and R&D investment. We continue to pay an attractive dividend. We've got a strong track record of double-digit growth, and I talked a bit about that in my remarks -- 19% compounded over the last three years.

As we went back this past year, we started out the year at a $200-million target for share buyback, and we ended up at $300 million. If you look at the last three years, is $1.2 billion in share buyback; so it's been a pretty healthy amount of shares repurchased in the marketplace, reducing our share count by about 15%. And again, we're guiding to $200 million this year.

As you know from our balance sheet, we don't have any debt due until the end of 2017, and we continue to focus on generating strong free cash flow; I think our FY14 results point to that. We're targeting next year 100% of [that] income again. Certainly our executive team is now incentivized on free cash flow, and that's been a change in the last couple of years, and I think the results are showing through in our numbers. And we'll continue to reevaluate over time how we deploy our capital.

So, thank you very much, Omear.

Omear Khalid - *Goldman Sachs - Analyst*

Thank you, guys; that's really helpful. Another quick follow up: You did discuss the international and tactical radio trends for the quarter and the year there. What was international book to bill, both for the quarter and the year? And is there any timing profile that you can give us an update on, as to how we think about these awards for the next fiscal year?

Bill Brown - *Harris Corporation - Chairman & CEO*

We don't talk about the individual components within tactical between US and international, in terms of bookings or book to bill or things of that nature. I think as you've seen in the report, the tactical book to bill in the quarter was about 0.67; for the year, it ended up about 0.86.

The international business, as I mentioned in my remarks, was very, very strong. It was up 25% the year, and ended the year very strong in Q4 with up 11%. And as I did mention, the pipeline is strong at about $2.5 billion, up a bit from the last time. So we remain encouraged by the trends that we're seeing on the international side.

Omear Khalid - *Goldman Sachs - Analyst*

All right, great. Thank you, guys.

Operator

Joe Nadol, JPMorgan.

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

Bill, on the 2015 outlook, what is your plan for domestic versus international tactical radio growth, if you are willing to share that?

Bill Brown - *Harris Corporation - Chairman & CEO*

Yes, at RF overall, it's flat to down 3%, and we see tactical down low-single digits. We see the international side up low-single digits; and on the DOD side, down low-double digits, so read that 10%, 12%, in that range.

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

Okay.

Bill Brown - *Harris Corporation - Chairman & CEO*

So, just to complete that, PSPC about flat -- just to complete the circle on the RF Comm segment.

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

Right. And then, on the international front, you upped -- you gave some commentary certainly already, and you upped your pipeline, and you said I think it was early-stage opportunities. I was wondering if maybe you could help us think through that $2.5 billion from a timing standpoint. Are there near-term bulky or good-sized orders out there that you think you can pull in before the end of the calendar year? And then maybe a little more color on what the early-stage opportunities look like.

Bill Brown - *Harris Corporation - Chairman & CEO*

Yes, the pipeline came up a little bit, and it was, as I did mention, some earlier-stage opportunities, but we still feel very confident about the size of the pipeline. As I mentioned, coming off a year where we booked a lot of good orders and grew our Business by 25%, which I think is astounding to see the pipeline replenish itself and actually grow a little bit is -- I think is very, very significant to us.

We see about $750 million of that $2.5 billion that are in the proposal, closure, finalization stage. So the probability is very high; the timing, Joe, as you know, is always a bit difficult to predict.

The shape of the pipeline looks pretty much in line with what I mentioned last time. It's slightly more than half Middle East and central Asia where we know that there are a number of security concerns; you can pick up a paper and read about that quite a bit, and US is pulling back.

Iraq is significant; I mentioned that last time, and it remains a significant component of our pipeline to date. It's both the Ministry of Interior, as well as the Ministry of Defense. We booked an order very recently in Q4; it's a little small, but I think it was significant. It's gotten through the vast majority of the licensing from the US government, so it feels very, very good.

We see opportunities in the country in Northern Africa that remain very robust. It's a phase 4 of what has been a long-term multi-phase program for us, where we actually have constructed an in-country assembly facility. So we know we've got a lot of staying power with that particular country.

And then within the Middle East, the UAE looks strong, Jordan looks strong, Oman is strong, Saudi has gotten a little bit bigger over the last couple of months to quarter, and we feel fairly good about those opportunities. The balance -- the other half, or little less than half, are just as we mentioned before, coalition countries; it's countries in APAC like Australia, Philippines, others. And then in Latin America, Brazil looks pretty good, Mexico looks pretty good. As you know, Brazil -- we were chosen for the early part of the [Sys front] program; we see that accelerating through FY15. Long list of other opportunities, but in general, Joe, that's the shape of the pipeline.

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

That's helpful. And then just one more: R&D, you mentioned, I think it was 5.3% this year in terms of IRAD. What's your plan for FY15?

Bill Brown - *Harris Corporation - Chairman & CEO*

Well, when you look back, since I came here 2.5 years ago, we were about 4% of our revenue being spent in IRAD internal R&D, and now, that's right, it's 5.3%. So it's come up quite a bit in the last 2.5, 3 years. I think it's -- we tried to point it towards those businesses where we have strong returns and strong growth opportunities based on technology and innovation. So we pointed it directly at our tactical business, and we've stepped up quite a bit as well in our government communications business. So it's 5.3%; it's a pretty healthy amount of spend.

We believe we are fully funding the best opportunities. We're looking across the Company now as a portfolio, as opposed to looking at the individual businesses on a siloed basis. We have a significant amount of engagement by our Board in R&D since it's such a significant investment and strategic to the Company. But as I go forward into 2015, we may see a slight tick up, but not to the magnitude we've seen in the last two to three years, Joe.

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

Okay, thanks very much.

Operator

Carter Copeland, Barclays.

Carter Copeland - *Barclays Capital - Analyst*

Quickly on INS, looks like, with the growing pieces, that IT services looks like it's probably down in the mid-teens range in the guidance for next year; is that right? And can you comment at all on what the underlying trends in the business are ex-NMCI?

Bill Brown - *Harris Corporation - Chairman & CEO*

Yes, let me start, and maybe Mick can jump in here a little bit. Clearly, we still are in a relatively constrained government market. The procurements are slow, there's been a lot of competition on the IT services business and the government side of CapRock. Some of it is offset with some improvements on commercial CapRock, as well as the commercial healthcare business.

As we look out into FY15, total INS down 7% to 8%. We see continued growth on the commercial side of CapRock, which we see up high-single digits, as well as the commercial side of the healthcare business, which will be up -- again, it's a small piece -- of up around 20% or so. And that's going to be offset by a weak US government IT services market; that'll be down high-teens. So your mid-teens is in the ballpark what's more like high-teens.

And the US CapRock side of the government side will also be down a little bit, mid- to high-single digits. But that's coming off a very, very weak FY14 where our government side of CapRock was down in the mid-20%s -- like 24%, 25%.

I think what's significant here, Carter, is that we're seeing two things happening in the IT services business. One is the roll off of the NMCI contract; Mick mentioned that. That's worth $90 million of revenue, and about $40 million of profit roll off between 2014 and 2015.

And then the other part is: We have decided to not sell [in the net sense] products, IDIQ, because it's simply pass-through businesses coming through a zero gross margin. It is adding nothing to our shareholders. Those two pieces -- those two decisions together are $160 million worth of revenue. So you pull that out, and it would make the HITS business to be roughly flat year over year outside of those two moving parts. And hopefully it gives you a little bit of color within INS, and I answered your question, but let me know if there's anything else you want to know about INS.

Carter Copeland - *Barclays Capital - Analyst*

No, that's exactly it; I wanted to get to what the business looked like ex those movements. So that color is really helpful.

Secondly, if you could give us a little bit more color on PSPC for next year and the flat guidance there? I wondered if you might just talk about the environment there, bookings trends, any challenges on the state and local side -- just anything to help us understand the directionality of that business next year and then beyond, and if your views there have changed at all?

Bill Brown - *Harris Corporation - Chairman & CEO*

Yes, look, it hasn't changed a lot in the last three months since the last quarter. The issues we have in PSPC remain two-fold. One is both the market itself, and the market appears to be getting a little bit weaker than where we were just a couple of months ago.

And there's execution; and I don't want to pile on the execution issues. They're going to take a number of quarters to fix. We have seen some delays in the roll out of some systems due to some customer issues. I think we're responding.

As I mentioned last time, we're adding on the sales and marketing side. We're investing in our product offering. We're investing heavily to improve the quality of our software architecture and our product that we're selling into the field, all of which I think are positive things that will help us over time. But what I've seen as I really have spent a little more time on this business: There's no silver bullet here.

On the market side, it is a bit weaker than where we thought just a few months ago. We now see the market to be down -- maybe flat to down mid-single digits as opposed to being more flattish. And what I think is happening here -- we're caught between two pieces. One is the rebanding that happened and ended around January 13 that had a positive effect, and maybe pulled forward some sales.

And then on the right-hand side or the later side is the investments that are coming down the path on LTE. And what I think is: We're stuck in the middle where we're winding down from the rebanding, and customer -- state and local customers are waiting for the uptick on LTE, and I think that's what's compressing the market that we're in today.

So I think the state and local finances are a little bit better, but we don't see that reading through right now into opportunities for public safety. I think when you step back and you look at it longer term, we do know that those analog systems that are out there, and there's quite a few, will shift to digital. LMR will move to LTE over time. I think we're taking all the right steps to take out costs, to position our product to be successful, to upgrade our management team. And I know we've got margin expansion opportunity. So I think, for Harris, public safety will be a long-term growth story; it's just going to take a little time for that to figure itself out.

Carter Copeland - *Barclays Capital - Analyst*

Thank you; that's really helpful color, Bill.

Operator

Yair Reiner, Oppenheimer.

Yair Reiner - *Oppenheimer & Co. - Analyst*

Start with a couple questions on RF; I think backlog total between tactical and public safety is down about 15% exiting 2014 relative to 2013. But your guidance for 2015 revenue is pretty close to flat. I'm wondering: What is it about either the backlog or the pipeline that gives you confidence that the turns business will be better than it typically is, in 2015?

Bill Brown - *Harris Corporation - Chairman & CEO*

Well, I think on public safety, we're coming off of a fairly weak 2014 -- FY14, and in a market that's soft to down a little bit. I think if we just hold share, we'll see our Business stabilize. And I feel reasonably confident that we'll see better performance in public safety in FY15 than 2014. It may not be up, but we're guiding to being about flat right now.

I think on the tactical side, look, we do know that we're ending the year with our backlog down a little bit; it's about 24% year over year. It declined sequentially by about 17%. We anticipated some decline coming off of a pretty strong Q2 and Q3. So we thought that was going to end up happening.

Typically what we see in a year is about 60% of our backlog converting to revenue in the subsequent year; we have some multi-year orders in our backlog today. Last year we converted about 60% of our backlog in 2014. The year before was just over that -- around 61%, 62%, so that's not unusual.

Then we're also seeing, in the 65% to 75% range of new orders converting within the year. That's what we've seen over the last couple of years, and we expect to see the same trend going into FY15.

So, Yair, when you put those two pieces together, I think we're pretty confident about the guidance and the outlook we have for both tactical and public safety. As I come back and I look at where we're at in the pipeline, the DoD pipeline down a little bit -- $900 million to $1 billion range. So it's holding in there even without any HMS opportunities in there. And with the international side remaining relatively healthy at $2.5 billion, we do know that some of those opportunities will come to bear in FY15. I think all of that taken together is what gives us confidence on the guidance for next year.

Yair Reiner - *Oppenheimer & Co. - Analyst*

Got it. And then, in your prepared remarks, you referenced I think $200 million to $300 million in unspent JTRS funding. I just want to make sure that I understood you correctly. Is your belief that that will be repurposed in order to fill the fielding gap, which will potentially be used for your products? And if so, over what time span do you expect that $200 million to $300 million to be spent?

Bill Brown - *Harris Corporation - Chairman & CEO*

The $200 million to $300 million at the end of GFY15 was on the HMS line. So on the MNVR we think is $60 million to $65 million, in that range; so, just to distinguish that. And, yes, there are -- the Army can buy SRW appliques against that funding, and they can buy those appliques to plug some of the fielding gap. So that is our hope and expectation that some of that will happen over the course of the fiscal year.

Yair Reiner - *Oppenheimer & Co. - Analyst*

Got it, thank you very much.

Operator

Gautam Khanna, Cowen.

Gautam Khanna - *Cowen and Company - Analyst*

A couple questions: Given the JTRS delays you outlined, presumably the overall RF tactical market opportunity has declined in FY16, even though I understand your reported pipeline had already excluded a lot of that JTRS opportunity out. Is that a fair assessment? And if, in fact, the overall market opportunity has gotten stretched out a bit, what do you think that should portend for pricing, even in the international market for RF tactical product?

Bill Brown - *Harris Corporation - Chairman & CEO*

I think the market itself is going to be flattish in the next couple of years, to be honest with you. I think the international side, because we're a big player on the international front, I think the international could be up modestly. I think we did capture a little bit of share in our FY14, but it could be up modestly in our FY15.

The fact that the pipeline that's over 12 to 18 months hangs in there for US DoD at the $900 million to $1 billion range is an indication for the size of the market that happens to be out there in US DoD. Just because of the HMS moving out, and the funding is not in that pipeline, that was -- we took that out last time. So that really doesn't affect the way we see the marketplace.

There are a number of opportunities that we see coming on: resets of modernization in other parts of the military services. More than 60% of our US DoD pipeline is outside of the US Army. It's the Air Force, it's SOCOM, it's the Marine Corps that are modernizing and standardizing on Harris technology, and that still appears reasonably robust.

When you talk about pricing, we compete every day on pricing, both in the US DoD and outside of that. And in every discussion we have and every contract we sign, there's significant pressure on the pricing side. I think the fact that we bring significant technology to bear, and that we have a product that delivers in the field with very, very, very good quality, I think is -- allows us to hold on our pricing and our margins in the tactical radio business.

Gautam Khanna - *Cowen and Company - Analyst*

Bill, not to belabor the point, but you understand my question is not how you define the market, it's how all players that supply products that compete with RF tactical define the market. And I imagine on a net basis, even though your pipeline is flat to up sequentially, maybe the rest of the world wouldn't see it that way, and that would presumably drive some pricing pressure. But I guess you just don't see it that way; is that fair, Bill?

Bill Brown - *Harris Corporation - Chairman & CEO*

Look, I think the -- we see pricing pressure in the markets that we happen to be in. But keep in mind: When you are deep with a particular service in a country, those opportunities do tend to come back to you. You have incumbency; we have incumbency in some markets. So when opportunities arise, we tend to be at the front of the line for those kinds of opportunities. We do have difficult pricing conversations with every one of our customers, but I don't see it increasing measurably next year from where we were this past year on the international side.

Gautam Khanna - *Cowen and Company - Analyst*

Fair enough. And can you remind us: Of the [$260 million] to [$270 million] of R&D spend that you actually spent, how much of that is directed at RF tactical and -- in 2014, and then how are you adjusting that specific spend in RF tactical in FY15?

Bill Brown - *Harris Corporation - Chairman & CEO*

A fair amount of the -- about [$260 million] to [$265 million] -- you're very insightful on that number -- it's in that range -- on internal R&D is spent at the RF Comm business. And the largest piece of that is within the tactical business. I think it's safe to say it's in the $100-million range, but I don't think I want to get much more specific than that. It's a substantial amount of money.

As we go into next year, there may be a slight increase in that. It may come from other parts of the Company, as we see good returns and good investment opportunities in tactical radio. We may see some shift. Some of the increase that we saw in Q4 comes with adding of people, and those people carry into next year. So there'll be a natural increase next year just because of the annualization of some of the investment we made in Q4 -- not 100% of it, but some piece of it. So good -- a very good chunk of our investment is being spent in the tactical business.

I would also say: You can see the resilience we have in the GCS business, 0% to up 2% next year -- relatively strong this past year. We have stepped up our internal R&D spend at GCS as well, and I think that's paying dividends as well, Gautam.

Gautam Khanna - *Cowen and Company - Analyst*

Okay. One last one: If you could just comment on RF tactical assumptions for your foreign sales next year, FY15, maybe between systems and product? I think you've given some flavor on the mix, and is the mix more beneficial in that side of the Business in FY15 than it was in 2014? Thank you.

Bill Brown - *Harris Corporation - Chairman & CEO*

Yes, we saw, at the beginning of last year, and we talked about this quite a bit because we expected it would provide a little bit of margin pressure, that we would see substantial growth in the amount of systems we're selling into the international market. We expected at that time that the systems business would roughly double year over year. It increased quite a bit; it didn't quite double, it was up about 50%. And we see another increase going into next year of a substantial amount of -- relatively the same order magnitude, 40%, more or less. This year, this past FY14, it was around $180 million to $200 million worth of systems business on the international side. And it'll go up in the 35% to 40% range next year.

Gautam Khanna - *Cowen and Company - Analyst*

Okay, thank you very much.

Operator

Chris Quilty, Raymond James.

Chris Quilty - *Raymond James & Associates - Analyst*

Wanted to follow up on that FGCM award; I know it's IDIQ, but can you give us a sense of scale of the opportunity relative to your legacy program, just order of magnitude, how much bigger of an opportunity you see this as?

Bill Brown - *Harris Corporation - Chairman & CEO*

Yes, look, it's going to be substantial. We've done in the range of $30 million to $50 million a year with the NGA. And my comments, and I'll just repeat them here, that that business should double over the course of the next year or two, I think, remains the same, Chris. So I think that shapes and sizes the opportunity at a pretty high level.

Chris Quilty - *Raymond James & Associates - Analyst*

Okay. And talking about the HMS program, when you look at the upcoming NIEs, how well do you feel you're positioned in terms of having hardware in the field and the testing environment and any new requirements that have been placed on you?

Bill Brown - *Harris Corporation - Chairman & CEO*

There's been a lot -- frankly, there's been a whole lot that's been happening on the -- in that particular area. We just came off of 14.2. I think our performance on 14.2 was quite good. We felt very, very good about it, and I think we're well positioned in the upcoming NIEs.

I think, if you read -- I'm sure you have Chris -- a lot of what's written in the press and memos by very senior people in the military about the performance of the program of record and other parts, I think we are -- we feel very well positioned with our HMS offerings, both the ManPack and the Rifleman. We've talked here before about the advantages of our own ManPack product. It weighs less, it's smaller, has all the waveforms, doesn't need all the expensive appliques, it boots up quicker -- all those various things, and we feel very, very good about that.

And I think when I look at some of the comments coming out of the military based on 14.2 about weight, size, battery life, heat dissipation, I feel very good about where our product is going to stack up based on our long legacy of developing products in this area. We developed our ManPack product with an eye towards keeping the weight low, with an eye towards making it heat and thermally efficient. So we think that that is going to be a performance differentiator for us over time. So I feel very good about our product offering, both in what we did in 14.2, as well as what's coming up in FY15.

And I hope that answered your question, Chris.

Chris Quilty - *Raymond James & Associates - Analyst*

Yes, it does. And an update on the Rifleman?

Bill Brown - *Harris Corporation - Chairman & CEO*

The Rifleman is very -- we've got a great offering in the Rifleman Radio. It's -- for us, it's the US equivalent to our international soldier radio. We've sold 44,000 of those radios around the world, and I like where we stack up there as well.

We've got a product with a longer battery life, in excess of 12 hours -- shorter connect time to network. And I think, as you might have seen in a demo, it has a unique dashboard display at the top, providing operational network status, so battery life remaining, numbers of users on the net, et cetera. It's NSA certified. So we feel very good about our Rifleman Radio product as well.

And I think, over the last 1.5 years, you've been asking us quite frequently about NSA cert on the ManPack, and I did mention in my prepared remarks we got that in June. So both the ManPack and the Rifleman are both NSA certified at this point.

Chris Quilty - *Raymond James & Associates - Analyst*

Great. And final question: The announcement you had on the hosted payload on NEXT, I think $63 million --

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Bill Brown - *Harris Corporation - Chairman & CEO*

Yes.

Chris Quilty - *Raymond James & Associates - Analyst*

If I remember, your contract with Harris, or sorry with Iridium, was for something like $45 million. So was there upside to the program in terms of the number of -- or amount of hosted payload activity?

Bill Brown - *Harris Corporation - Chairman & CEO*

Yes, substantially. Aireon is a program -- it's a joint venture between NAV Canada and Iridium. And our contract is really with Aireon, and it's to put payloads onto this constellation.

And the total number of payloads -- I think it's 81 -- I think it's 66 satellites on orbit with -- on-orbit spares -- and on-ground spares. So I think it's a total of 81. And there's 81 payloads just for Aireon. And on top of that, there have been other payloads booked with other customers for that constellation.

And hopefully that answers your question, Chris.

Chris Quilty - *Raymond James & Associates - Analyst*

So this is upside on the -- I think it was 15% of the payload that you had reserved for classified customer activity, and the upside is on that portion of it.

Bill Brown - *Harris Corporation - Chairman & CEO*

I would just say that it is upside to what we anticipated when we signed Aireon, in terms of the payloads riding on that constellation. And I think that's all that we can say.

Chris Quilty - *Raymond James & Associates - Analyst*

All right, very good. Thank you.

Pamela Padgett - *Harris Corporation - VP of IR*

All right, and thank you, everyone, for joining us today.

Operator

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