THOMSON REUTERS STREETEVENTS

# EDITED TRANSCRIPT

## HRS - Q3 2015 Harris Corp Earnings Call

EVENT DATE/TIME: MAY 05, 2015 / 12:30PM GMT

**OVERVIEW:**

Co. reported 3Q15 revenue for Co. of $1.19b and non-GAAP EPS of $1.32. Expects FY15 revenue to decline about 4% and non-GAAP income from continuing operations per diluted share to be $5.00-5.10.





THOMSON REUTERS

## CORPORATE PARTICIPANTS

**Pamela Padgett** *Harris Corporation - VP-IR*

**Bill Brown** *Harris Corporation - Chairman and CEO*

**Mick Lopez** *Harris Corporation - SVP and CFO*

## CONFERENCE CALL PARTICIPANTS

**Carter Copeland** *Barclays Capital - Analyst*

**Noah Poponak** *Goldman Sachs - Analyst*

**Pete Skibitski** *Drexel Hamilton - Analyst*

**Gautam Khanna** *Cowen and Company - Analyst*

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

**Chris Quilty** *Raymond James & Associates, Inc. - Analyst*

## PRESENTATION

**Operator**

Good day and welcome to the Harris Corporation third-quarter 2015 earnings conference call. At this time all participants are in a listen-only mode. Later there will be a question-and-answer session, and instructions will follow at that time.

(Operator Instructions)

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

---

**Pamela Padgett** - *Harris Corporation - VP-IR*

Thank you. Good morning everyone. Welcome to our third-quarter FY15 earnings call. I'm Pamela Padgett, and on the call today is Bill Brown, Chairman and CEO; and Mick Lopez, 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 in respect of our third-quarter FY15 financial results is included 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. With that, Bill, I'll turn it over to you.

---

**Bill Brown** - *Harris Corporation - Chairman and CEO*

Okay, well thank you Pam, and good morning.

Our third-quarter results were in line with our preliminary release issued April 21, which opened our debt financing window for the Exelis acquisition. We had a very successful bond offering, and we're making progress towards an expected June closing, and will discuss this further later in the call. Before turning to Slides 3 and 4 of the presentation, I'll point out that we're now reporting on both a GAAP and non-GAAP basis to call out acquisition-related costs separately. My comments today will be around non-GAAP performance, which excludes acquisition costs.

Third-quarter earnings per share was $1.32, and benefited from a lower-than-expected tax rate that added $0.07 per share. Earnings per share also reflected good operating performance, benefiting from lower costs, excellent execution, and a favorable product mix in RF Communications and government communication systems. Operating margin was 100 basis points higher than in the prior year, even with higher R&D investment, which was up 8% in the quarter, with some of the increase due to timing between the third and fourth quarters.

Year to date, R&D revenue -- R&D investment is 5.6% of total revenue, with a significant portion being spent in the tactical radio business, where we are aggressively developing product offerings for upcoming Army and SOCOM modernization procurements.

Revenue for the Company was $1.19 billion, down 6%, with tactical revenue growth more than offset by further weakness in public safety, and a significant decline in integrated network solutions, primarily from the wind-down of two major programs in IT services. As anticipated, revenue also declined in government communications systems, largely due to a tough prior-year compare related to revenue from commercially hosted satellite payloads.

Orders in the quarter were $1.2 billion, up 9% over the prior year, and up 9% sequentially. Both RF communications and government communications orders were up sequentially. Tactical communications revenue was up 6%, on continued international strength, and some improvement in the US market. Procurement activity picked up in March and April, as GFY15 procurement dollars were allocated to our DoD customers, including SOCOM, where we received orders totaling $27 million to continually expanding their wide band networking capabilities. Momentum continues to build for US tactical modernization. Just last week, Harris was awarded a 10-year, $3.9 billion ID/IQ contract for the Rifleman radio, with an $800,000 initial order for qualification and test units. The Army expects to begin fielding Rifleman before the end of GFY17.

The Army also recently kicked off their long-awaited procurement for the Manpack. A draft RFP was released in April, and was quickly followed up by an Industry Day, as well as the first quarterly tactical networking forum, which is intended to provide the industry with greater insight into the Army's upcoming procurement requirements. The final RFP is anticipated before the end of September, with an award in 2Q GFY16, and full-rate production slated to begin in 4Q GFY17. Preliminary information from the Army indicates a 10-year, multi-award ID/IQ contract, with a ceiling value between $12 billion and $12.7 billion.

At SOCOM, last quarter we submitted our bid on a $390 million hand-held portion of SOCOM's modernization program, with an award anticipated in September. Just a few days ago, SOCOM issued an RFI for their Manpack, which we currently expect will be awarded in the spring of 2016. The total SOCOM monetization procurement, which will eventually include a high-frequency radio, could reach $900 million.

Now winning Rifleman radio on top of the mid-tier MNVR radio a years back, and now having major procurements under way for both the Army Manpack and SOCOM, is the culmination of a multi-year, multi-pronged effort for Harris. Over the last several years we have worked hard to ensure Army procurements are open to commercial competition, and have more recently pushed for a multi-vendor versus a single-vendor award, to ensure a level playing field with the program of record.

We invested more in IRAD when the rest of the industry was investing less, raising R&D spend by more than 20% through the down-turn. Today we stand with one of the best lineups of tactical products and technologies than we've ever had. With modernization procurements now under way and larger than anticipated, Harris is well positioned to capture a significant multi billion-dollar opportunity.

We also see continued strength in the international tactical market, where our business is now twice the size of our US tactical business. Recent orders include $25 million and $16 million from two NATO countries, highlighting that our broad installed base around the world allows it to be more competitive in supplying radios to allied countries where interoperability is a critical element for coalition actions.

We also received orders of $22 million and $47 million from two countries in the Middle East. From a country in Africa, we received $15 million in the quarter, plus another $74 million following the close of the quarter for their next phase of modernization, bringing orders to date to $486 million. The international market is healthy, and our opportunity pipeline remains solid at $2.5 billion, and continues to replenish quickly.

In government communication systems, we continue to build on our strong position with the FAA, and received our third major NextGen award, an eight-year, $238 million single award ID/IQ for the common-support services weather program, to design and implement a system to provide real-time weather information across the national aerospace system. Also from the FAA, we booked $146 million in follow-on orders under our long-standing FTI program, where we provide the ultra-reliable network backbone of the US air traffic control system, connecting 4,500 different sites across the country.

Our DoD business within GCS continues to ramp with F-35, and our strong intelligence franchise provides a platform for future growth. New classified contract wins in the quarter totaled $133 million, including a three-year, $23 million contract from a new customer for space situational awareness in support of Air Force missions. Also in the intelligence area, Harris was awarded a five-year, $300 million, single-vendor ID/IQ contract to integrate various intelligence systems.

Now I'll turn it over to Mick to comment on segment results and guidance before providing an update on the pending Exelis acquisition.

---

**Mick Lopez** - *Harris Corporation - SVP and CFO*

Think you, Bill. Good morning, everyone.

Moving to segment results on Slide 5, RF Communications orders were $393 million, compared to $405 million in the prior year; and revenue was $451 million, compared to $457 million last year. Tactical Communications revenue was $356 million and increased 6%, while orders were $286 million, and about flat from prior year of $285 million.

In Public Safety, market softness and intense competitive pressures continued. Orders were $107 million, compared to $120 million in the prior year, and revenue was $95 million, compared to $122 million last year. Operating income for RF Communications was $151 million. Operating margin was a strong 33.5%, as a result of favorable mix, primarily in international, and from lower costs.

Turning to government communication systems on Slide 6. Third-quarter revenue was $455 million, down 5% compared to $477 million in the prior year. Higher revenue from the US Navy's commercial broadband satellite program and the NGA's Foundation GEOINT content management program was more than offset by lower revenue from space customers, and from NOAA's GOES-R weather program, that's transitioned to an integration and test phase. Segment operating income was $75 million, and operating margin was 16.4%, reflecting strong program performance and favorable product mix.

Turning to Integrated Network Solutions on Slide 7. Third-quarter revenue was $299 million, compared to $348 million in the prior year, with the decline primarily due to the roll-off of two large programs in IT services. Operating income was $12 million, compared to $21 million last year, primarily due to the wind-down of the highly profitable NMCI contract.

During the quarter, IT services was awarded a 10-year, $450 million, single-award ID/IQ from the Defense Information Systems Agency to provide systems engineering and program management services for their crisis management system, or CMS, a secure video and voice communications network for senior US government officials. This award extents our thirty-year relationship supplying this critical component of our national security infrastructure. Also in IT services, we were awarded a position on the $960 million multi-award ID/IQ contract for network-centric solutions to application services.

In CapRock, we strengthened our relationships with two long-standing energy customers. In the quarter we received a $35 million order from a major offshore oil and gas driller for a four-year extension of services across their fleet, and two orders totaling $21 million from a leading energy services Company, extending services across the United States and international locations.

Turning to Slide 8, the Company generated free cash flow of $150 million, up from the prior years $120 million, as a result of lower CapEx with the completion of GCS's new engineering facility. Our non-GAAP tax rate was 29.9% in the quarter, lower than previously expected, due to favorable 2014 tax settlements.

As announced on April 21, we increased FY15 guidance for non-GAAP income from continuing operations per diluted share, from a range of $4.95 to $5.05, to a range of $5 to $5.10, and updated revenue guidance from a decline in the range of 1% to 3% to an expected decline of about 4%. FY15 non-GAAP guidance does not include any impact from the pending acquisition of Exelis. GAAP results will include potential post-closing revenue and income from Exelis, increased share count from the transaction, and acquisition-related costs that are expected to be in the range of $270 million to $290 million, including $125 million in estimated May [coal] costs associated with the refinancing of Harris debt.

In RF communications, to reflect further weakness in public safety, we now anticipate revenue to be down 3% to 4%, and expect to be at the higher end of our previous operating margin guidance of 30% to 31%. In Government Communications Systems, revenue guidance is unchanged at up 2% to 4%, with operating margin slightly higher, in the range of 15.5% to 16%.

In Integrated Network Solutions, revenue is now expected to be down 14% to 15%, to reflect no improvement in the slow procurement environment for IT services, and an incrementally softer outlook at CapRock, due to the impact of lower oil prices on the energy market, and to a lesser extent in health care, due to a slower revenue ramp. We now expect FY15 operating margin of about 6%. Expectations for free cash flow are unchanged at about 100% of non-GAAP net income. The tax rate is now expected to be 30%, which adds $0.05 earnings per share for the full year.

Back to you Bill.

---

**Bill Brown** - *Harris Corporation - Chairman and CEO*

Okay, thank you, Mick.

When we began FY15, we anticipated that the constrained budget environment and slow procurement would create some revenue challenges. In Government Communication Systems, where we're on a path to revenue growth for the fiscal year, our strategy of expanding already strong franchises helped overcome government budget constraints.

In RF Communications, strength in international tactical markets has continued, and we have a healthy set of opportunities. While it's premature to call a bottom for the US tactical market, we're seeing the back half improvement we expected, and the momentum building on the large DoD modernization procurements is encouraging. In both Government Communication Systems and RF Communications, bottom-line performance is excellent.

While we see positive indicators in our two largest businesses, our revenue challenges in FY15 have been greater than anticipated in Public Safety and in Integrated Network Solutions. In Public Safety the market is soft and competition is aggressive. We're focus on recovery and making measurable improvements in quality and execution, and we continue to build our leadership team and invest in new products. This quarter we introduced our new XG-15 portable radio, which extends our full suite of product offerings, and provides public service workers with P25 capability at a competitive price. We'll continue to focus on execution and delivering innovative products to our customers, which we believe will ultimately bear fruit as the market improves.

In CapRock, while orders were up 24%, with energy orders up 27% in the quarter we now expect first-half revenue growth to turn into a revenue decline in the back half. Our customers are reacting to the persistently low oil prices, and taking actions today that even they didn't contemplate just a few months ago. We are responding by not only working to lower costs, but to also provide technology that will improve the competitiveness and stickiness of our managed communications offerings. In 3Q we launched what we call CapRock One, a multi-band antenna and software that transparently switches between C-, Ku-, and Ka-bands to provide the most optimal and cost-effective transport medium, and is getting great response in the market place.

The acquisition of Exelis builds on the stronger parts of Harris, and is an exciting transformative new chapter for the Company. We've now secured debt financing for the acquisition, and at very favorable terms, which we've outlined on Slide 10. A $1.3 billion, variable-rate term loan is in place, which provides us a path for quickly deleveraging post-acquisition; and we recently issued $2.4 billion in bonds, a portion of which will fund our redemption of $750 million in existing higher-coupon Harris notes, to take advantage of low interest rates and to extend maturities. The $2.4 billion of new bonds are at a weighted average coupon of about 3.7%.

As anticipated, we significantly reduced our weighted average cost of debt, including the variable-rate term loans, to about 3.5%, 240 basis points below our previously weighted average cost of 5.9%, and with two years longer time to maturity. We now expect year one net interest expense of $180 million to $190 million, and our balance sheet will retain ample liquidity, with about $300 million of remaining cash on hand, and an existing revolver of $1 billion.

While we receive a second request from the department of justice, we don't expect any trust clearance to require the divesture of any business or asset. The request for additional information as related to intellectual property needed to update the encryption in SINCGARS radios to meet an NSA 2024 requirement for secret communication. The Army is considering whether to upgrade the encryption capabilities of these older radios, and much of the information requested is intended to help determine if the Army has all the intellectual property it would need to enable other companies to compete for that encryption modification work. We anticipate resolving these concerns promptly.

The Exelis shareholder vote has been set for May 22, and we continue to expect the transaction to close in June. Integration planning is well under way, with a full-time, highly experienced team led by Sheldon Fox, Group President of Government Communications Systems. Sheldon is a 31-year veteran of the government market, with deep experience in key areas where Exelis and Harris have complementary businesses, such as in space and intelligence, advanced weather systems, and air traffic management.

Of course, I'm personally deeply involved, and will spend a significant amount of my time over the next several years to ensure we capture the full value of this acquisition. Since announcing the acquisition, the additional work we've done has only given us more confidence in delivering the previously estimated savings of $100 million to $120 million, which you'll remember is net of what flows black through to our government customers. We're working hard to accelerate synergy capture, and be at a running start on day one following the close.

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*

Good morning, guys. Just a couple of quick ones. First on the CapRock decline, I know last quarter you had sort of outlined that you were protecting for weakness in that market, but not really knowing how to size it just yet. Obviously we're a quarter on now. What sort of declines are you expecting now at this point? Do you think you'll hit a run rate decline by the end of the year that levels off? How should we think about how much of that is price versus volume? Is there any EBIT-related impacts from unsold bandwidth that you can't sell on some of the current contracts right now? How should we think about the weakness there?

**Bill Brown** - *Harris Corporation - Chairman and CEO*

Let me describe what's happening at CapRock, and then come back to question about the bandwidth, unsold piece of bandwidth. I think we had a really good start to the year, frankly, in the CapRock business. Revenue in the first half was up in the 3% to 4% range, double-digit, low double digits on the commercial side, somewhat weak on the government side, but overall up 3%, 4% in the first half. We are pretty pleased with what is happening in the maritime space. Frankly, in the energy side, the orders in the last two quarters were quite good and surprisingly good, up about 25% in Q2, and again, a little bit better than that in Q3.

We do see revenue deteriorating sequentially and year over year in the third quarter, and we expect that to continue, Carter, into the fourth quarter, as well. It will be down probably double digits in the fourth quarter on the energy side. We do see CapRock as a whole being flat to down for the year, and down in the back half.

With oil that's now sitting in the $50 to $60 per barrel range, I think customers today continue to react quite aggressively to what's happening in the global oil markets. They're trying to anticipate where pricing is going to be. They're taking very aggressive actions. Like I said in my remarks, somewhat unpredictable as to where we were and what they were going to do back in early part of February. They're doing a lot of restructuring, capital spending is coming down. They're parking and maybe scrapping some rigs, delaying the awards and acceptance of new rigs. That's certainly having a pretty big impact on our business.

When we look at what's happening in this down-turn versus last several down-turns in this global oil market, we see rig count down about 30% by the end of March. I would say we are maybe a little bit beyond halfway through the down-turn, so we do expect further erosion. We do expect it's going to carry into 2016 and be a tough 2016 for us. We think the road here is going to be slow in terms of stabilization and a long recovery.

But I would say for CapRock as a whole, recall we've talked about the size of our energy business at about $400 million. It's about 8% of total Harris as we speak today, even smaller when we combine it with Exelis. It's not a big part of the Company, but we do expect further pressure in the fourth quarter in the next year on the energy side, and that's going to drag down CapRock.

In terms of the bandwidth, fortunately we do see quite aggressive growth in the maritime space, particularly in the cruise industry. That's offsetting some of the pressure that we're seeing in the energy space, and some of the bandwidth that we've procured for the energy side.

**Carter Copeland** - *Barclays Capital - Analyst*

You think this will be -- you'll find a bottom, both revenue and margin terms, there in FY16?

**Bill Brown** - *Harris Corporation - Chairman and CEO*

We're not going to call 2016 yet, but we do see 2016 being softer than we are seeing right now in 2015, Carter.

**Carter Copeland** - *Barclays Capital - Analyst*

Okay. Then a quick follow-up, just to switch gears quickly on the Exelis synergies you briefly mentioned. You talked about accelerating the synergy capture there on the $100 million to $120 million. Now that you've had a couple of extra months to go through this, do you think there's upside to that number over time? Any color in the work you've done in identifying and sizing those opportunities?

**Bill Brown** - *Harris Corporation - Chairman and CEO*

No Carter, no more color today. We still feel very comfortable at that $100 million to $120 million by year three, net of what's going to be flowed back to our government customers. We're working hard at it, and we're doing a lot of pre-close planning independently on our own, with some outside advisors in the clean-room type approach. We do expect to be running that business at closing, and we want to pull forward as much as we can. But no more color today. We're working right now on getting to a close.

---

**Carter Copeland** - *Barclays Capital - Analyst*

Great. Thanks a lot, Bill.

---

**Bill Brown** - *Harris Corporation - Chairman and CEO*

You bet, Carter.

---

**Operator**

Noah Poponak, Goldman Sachs

---

**Noah Poponak** - *Goldman Sachs - Analyst*

Bill, can you go back to that detail you were providing on the second DOJ request? It sounded like they were thinking about a technology upgrade, and checking if they have a certain amount of IP? What would happen if they did want to do that and they didn't have enough IP? Can you give us a little more detail on how concerning that is to you, or not?

---

**Bill Brown** - *Harris Corporation - Chairman and CEO*

While I can't really give a lot more detail on this call, there's been -- as you would expect, there's active conversations going on with the DOJ, and this could go in a variety of different ways. I think a couple of things, I would say. Not to just reiterate what I said in my prepared remarks, but I think the good news is that it is narrowly contained in the tactical radio side. It specifically relates to IP and ownership rights for IP. It does not, and we don't believe it will require any divestiture of businesses or assets.

We think we can get our arms around the concerns of this issue relatively quickly. We're working in providing the DOJ the necessary information that they require to work through and resolve this question that they happen to have. We'll have more to say over the coming weeks as we take this issue forward to the DOJ. Nothing -- I can't really speculate on what the outcome or solution may be, here on this call.

---

**Noah Poponak** - *Goldman Sachs - Analyst*

Could they just require you to give IP to the Army? Could it be that the simple?

---

**Bill Brown** - *Harris Corporation - Chairman and CEO*

There could be a variety of responses. Certainly that could be one, but I wouldn't even speculate as to where they want to go in terms of addressing the particular question, given that it's a very active conversation that's happening today with the DOJ. I don't think I could provide any more color to that, Noah.

---

**Noah Poponak** - *Goldman Sachs - Analyst*

In the legacy business, with -- when we look at -- before you're layering in some of the new business you're winning, and in the domestic tactical radio market with DoD, how do we think about how much of what you have today you'll still have two, three, four years down the road, when you're also layering in all of this new business, versus how much of what you have today is replaced by that new business?

---

**Bill Brown** - *Harris Corporation - Chairman and CEO*

There is certainly going to be some replacement of current business, but I think it's on the margin, frankly, and it's going to happen over a long period of time, Noah. Keep in mind that of all of the radios that are today in DoD inventory, it's less than 10%, maybe 5%, 6% that are wide-band capable. I think it's a long-term path to replace all of those narrow-band radios with wide band radios. I think that's going to happen over multiple years, not multiple quarters.

---

**Noah Poponak** - *Goldman Sachs - Analyst*

Okay. Anything you can tell us about Rifleman terms of trade in your bid, and how we can think about margins on new business revenue compared to the current margins at RF?

---

**Bill Brown** - *Harris Corporation - Chairman and CEO*

I really like the position that we are in today. It's something that didn't happen overnight. It happened over multiple years in both ensuring competition was -- it was open to competition, we can compete for those procurement dollars, and that we invest and had a radio that met the requirements -- in fact was in some ways more advanced than where the program of record was at the time, which is what's caused some change in the competitive landscape for the Rifleman radio.

We are bidding on commercial terms. It's a competitive procurement. It looks much the same as what happened on the Fisher program a number of years back, where it was a IDIQ shoot-out between us and [Tallas] on task orders. It was completely commercial. Initial awards for Rifleman are going to be LPTA, low price technically acceptable. Over time there will be some best-value type opportunities for us.

What's interesting is that the ceiling value is quite high at about $3.9 billion. In the Rifleman, the RFP, it was both the single-channel Rifleman, but also they started to introduce a two-channel hand-held over time. How that gets shaped, and when that's being brought in is still all to be determined.

I like our position. I like our scale. I like the advantage our technology brings. I like the fact that our commercial model allows us to continue to invest to advance our technology and compete with whatever we happen to have. Our margins today on the hand-held look great, and it's even after competing with players around the world on this Fisher program. I like what we have and the outlook for our business, both top line and bottom line.

---

**Noah Poponak** - *Goldman Sachs - Analyst*

Okay, thanks a lot.

---

**Operator**

Pete Skibitski, Drexel Hamilton

---

**Pete Skibitski** - *Drexel Hamilton - Analyst*

Good morning, guys. Nice quarter.

---

**Bill Brown** - *Harris Corporation - Chairman and CEO*

Thanks, Pete.

---

**Pete Skibitski** - *Drexel Hamilton - Analyst*

Bill, you sort of anticipated my question on US DoD radio volume, and whether or not we were at trough in FY15. The volumes have come down quite a bit. You've won Rifleman, you mentioned MNVR. What else are you looking for to signal we're at the trough? I imagine the SOCOM win, if you could get that, would help quite a bit. Are you worried about a CR next year? What else is going into your thinking?

---

**Bill Brown** - *Harris Corporation - Chairman and CEO*

We feel really good about where were at, Pete, frankly. Just the fact that the Rifleman IDIQ was awarded last week -- I think you've ever heard me say sooner than we expected when I talk about government contracting, and it was sooner than we expected by a number of months. That's because of the changes that happened in the industrial base for the Rifleman radio, I believe. It came in a lot higher than we thought.

It's encouraging to see the Manpack moving forward. It's encouraging to see the SOCOM modernization moving forward and an RFI out last week for the Manpack part of SOCOM. We're starting to see some movement here. As I said in my remarks, it's tough to call the bottom. We are seeing both sequentially and year-over-year improvement in the second half, and we expected that would have happened at the beginning of the year.

As you look at the budgets, there's still a lot going on in DC. The outlook I think looks good for us. It's improving a little bit. Looking at what's happening coming out of the House Armed Services, we see what the mark-up that they came out with last week it was, or early last week, which shows the base at the BCA cap, but a substantial amount of OCO funding in total at $585 billion, in line with where the president happens to be.

If it follows the way we've seen in past years, in terms of how the budget flows down to tactical radio line items, I think if it follows that, it will follow where the President happens to be. The President put in a budget for -- which would show good funding, good funding growth on the MNVR product, good funding growth on HMS, and good funding increases in the other services. I think that's quite encouraging.

For the HMS, which is the Rifleman and the Manpack, there's a lot of unspent funds still available. As you look at the ramp, it ramps relatively quickly over the next two to three years to close to $0.5 billion a year, again in the President's budget a couple of years out, which I think is quite encouraging. You put that fact that the Army's meetings moving forward with the budget next to the fact that the funding appears to be ramping pretty nicely over the next three or four years, you put those two pieces together, and I think the outlook for our business in DoD is pretty positive.

---

**Pete Skibitski** - *Drexel Hamilton - Analyst*

Very helpful, thank you. I want to ask another question about the transaction. Do you guys still plan on paying off roughly half the debt you incur over five years? Is that still the plan?

---

**Bill Brown** - *Harris Corporation - Chairman and CEO*

Our plan is to go from 2.9 to 1.5 times net leverage over the first three years, which would require us to pay, make down, $2 billion of debt, roughly, plus or minus in the first three years.

**Pete Skibitski** - *Drexel Hamilton - Analyst*

Okay, got you. On the acquisition-related costs, roughly $280 million. Are those all cash, first of all, and we'll get about $125 million of that in the fourth quarter on the refinancing costs?

**Mick Lopez** - *Harris Corporation - SVP and CFO*

Yes, most of those are cash. $125 million, as we stated, are for the may call for the $750 million of refinancing. There's approximately another $75 million which is going to be acquisition related with Exelis, severance fees, lease cancellations, restructuring of the sort. The remainder is basically deal costs and financing for the bridge and some negative carry. So most of it is cash.

**Bill Brown** - *Harris Corporation - Chairman and CEO*

I would also just say that again it all presumes a June close. We expect a June close, but that all presumes June closing.

**Pete Skibitski** - *Drexel Hamilton - Analyst*

Okay, great. Thank you very much, guys.

**Bill Brown** - *Harris Corporation - Chairman and CEO*

Sure.

**Operator**

Gautam Khanna, Cowan and Company

**Gautam Khanna** - *Cowen and Company - Analyst*

Thank you, good morning.

**Bill Brown** - *Harris Corporation - Chairman and CEO*

Good morning.

**Gautam Khanna** - *Cowen and Company - Analyst*

Bill, could you comment on what effect, if any, the strengthening dollar and softer oil prices have on your foreign pipeline at RF?

**Bill Brown** - *Harris Corporation - Chairman and CEO*

On the price of oil, I think it's a bit hard to say. We haven't seen any significant impact at the moment. We do know that more than half our international pipeline is in the Middle East, Northern Africa region. What's interesting is even though as the price of oil has come down quite precipitously over the last six to nine months, that piece of our pipeline on a percentage basis and the dollar basis is where it was six to nine months ago, even after booking a number of large orders, including one that came out just a couple weeks ago in Africa at $74 million. We feel pretty good about that.

We do know that we have a large opportunity coming over the next several years in Iraq. We do know that the country doesn't have a lot of foreign currency reserves. Oil is going to be a bigger impact on Iraq, but fortunately it's sort of under-pinned by US funding, both in the FY15 budget as well as in the FY16 proposed OC elders funding for the Iraq trained and equipped funding, so that does back-stop us a little bit for any oil-related concerns in Iraq. Overall, not a concern today. It doesn't mean that won't come in front of us over the next number of quarters.

On FX, I think you know we do business around the world in US dollars, and we compete against in some markets euro-based competitors. Over time that could have some marginal effect if we don't adjust price, and if the euro doesn't improve. We've seen updates in the last couple of weeks the euro getting a little bit better. Today no big effect; but again, if the dollar strengthens considerably from where we are today, there could be some effect, and we'd have to react with pricing.

---

**Gautam Khanna** - *Cowen and Company - Analyst*

Okay, and two others. Given the booked-to-bill at tactical RF was under one again, I wonder can you give us a sense for what you anticipate over the next couple quarters? You mentioned the improved procurement environment since the quarter. What should we expect booked-to-bill to trend at in the next couple quarters?

---

**Bill Brown** - *Harris Corporation - Chairman and CEO*

Year to date booked-to-bill was about 0.87. I think given the current US government environment and some of the pretty healthy shipments we've made internationally, I think is a pretty good result that 0.87. In order to hit our numbers for the year and our guidance for the year, booked-to-bill for the year needs to come in pretty close to 1.0. We do know there is some big opportunities that are coming our way in Q4, and it's good again to point out that we received a pretty good size award on the international side, $74 million, just a week or two ago. That's I think a good, positive sign.

I'm not sure I'll go into FY16, but certainly as we look out to the balance of the year, which is only a couple of months away to the end of our fiscal year, we're down year to date about 1% on tactical revenues. Obviously to be up low single digits on the year, call it a couple percent, we do need to see some good growth in the fourth quarter. That's going to come with some good orders that we do expect.

The international side has been trending pretty well. It's up high single digits. We expect it to be up high single digits for the year, which means Q4 is going to be about that same level of performance. On the DoD side it has been softer. On a year-to-date basis we are down sort of in that 20% range. We're guiding to be in our guidance that we expressed a little bit while ago on where RF as a whole is. Embedded in that is DoD down 10% to 12%, and probably on the better side of that may be down about 10%. That requires Q4 to be quite good.

We typically see, Gautam, Q4 being stronger sequentially from Q3. We saw that last year, where Q4 revenues about doubled where we were in Q3 last year. We did see some positive movement in DoD in Q3, and it was reassuring to see positive growth after a number of quarters in a row of being down year over year on a DoD.

I'm also glad to say that the pipeline for DoD is getting a little bit better than we were three months ago. Last time we spoke it was about $900 million or so in size. Today it's about $970 million. There's more that's weighted towards proposal closure and finalization, so the nearer-term pipeline is looking a little bit better. That gives us a bit of more comfort that Q4 will be better year over year and better sequentially than Q3. We're counting on that to hit the guidance, and to again come back to a full year of close to a 1.0 on booked-to-bill. I won't speculate at the moment going into FY16. I'll have more to say about that once we close Exelis and report our earnings in late July.

---

**Gautam Khanna** - *Cowen and Company - Analyst*

Okay, one last one. On the LTTA environment we're seeing on the Jitters programs, can you comment on what you anticipate? How is this going to drag margins as these programs mature? I presume much like in the seizure of contract, you'll see substantial price reductions over time. I'm curious -- I think Noah asked the question of cannibalization earlier. I'd like, maybe if you could more broadly address it -- not just in terms of do the new programs replace the single channel 117 G sales if you win Manpack, for example, but also broadly on pricing. Are we going to see a big price down in the business that's going to take our view on RF tactical margins much lower than where they are today?

---

**Bill Brown** - *Harris Corporation - Chairman and CEO*

Gautam, this has been over a number of years a very price competitive market place. Frankly, over the last three years since I've been here, the nature of competition, the mix of DoD and international, even with international by country is shifting around, increasing our systems business.

Yet still through all of that, we're sitting here with north of 30% margins in that segment, and even within spending a lot more on R&D and some shifts happening at public safety. Overall, we're finding a way to take cost out, preserve pricing, and still preserve our position and margins that are north of 30%. We're doing, I think, a very good job of managing our cost structure and prudently managing our investment pattern to maintain very strong margin in that segment.

I do think that over time, will become more price competitive? It is price competitive. The nature of who we compete against may shift a little bit, but the scale advantage we have in our RF facility in Rochester, the ability to drive technology differentiation into our product over time, are going to be the deciding factors over time in this business to be able to preserve margins north of 30% for the RF comm segment.

We're not putting our head in the sand saying that there aren't dynamics happening here, but I am confident in the team's ability to continue to find opportunities to both take cost out, as well as invest in differentiation to maintain a pricing environment that allows it to whole margins pretty strong in that segment.

---

**Gautam Khanna** - *Cowen and Company - Analyst*

All right, thank you.

---

**Bill Brown** - *Harris Corporation - Chairman and CEO*

You bet.

---

**Operator**

Josh Sullivan, Sterne CRT.

---

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

Good morning.

---

**Bill Brown** - *Harris Corporation - Chairman and CEO*

Hi, good morning.

---

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

One of your targets with the Exelis transaction is you want to achieve $1 billion in free cash flow by year four. Can you walk us through the cadence from year one to year four, and maybe what are some of the gating factors, given today's results?

---

**Bill Brown** - *Harris Corporation - Chairman and CEO*

It starts with -- and this is a very high level. It starts with what we believe our own ability to generate free cash is on a stand-alone basis. This year, if you look at our guidance, 100% of net income and the center point of our $5.00 to $5.10 earnings per share, our free cash will be -- mathematically is in that $530-million range. Where Exelis has been guiding for calendar 2015 is in the $250-million to $275-million range is what they've guided towards. You just put those two numbers together, and you're about $800 million on a pro forma basis, just putting two companies together.

You then add on top of that net synergies. Again, we're expecting $120 million net by year three. You roll that in on an after-tax basis, and then add in working capital improvements, capital efficiency, perhaps some modest adjustments over time in the cash pension costs, and you start to approach $1 billion by year four. That's what we expect, and that's what we communicated back in early February.

---

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

Okay, great. In the public safety business, is the pressure more on market demand or increased competition? Is that competition coming from existing or new entrants?

---

**Bill Brown** - *Harris Corporation - Chairman and CEO*

There's a lot of shifts happening in that public safety space. There is some consolidation. There are some shifts happening in technology. We have a very large competitor who is very focused, very aggressive, and in a market that's flat to down a little bit. Those are the dynamics that are happening in this particular market space. We compete in the North American LMR market. That's where we're at. Our big competitor has more of a global perspective in terms of their footprint around the world. The market is soft. It is very competitive.

I do think that we've had internally within Harris some executional challenges, which we're quickly working to solve. They're not going to solve themselves over the course of a number of months of quarters. It's going to take some time, but we're really focused on this. We are seeing executions slowly improving. We do see quality improving, we do see customer satisfaction coming back up. We're making progress in developing and expanding our product offering. Our team, our leadership team is getting better. Overall, I see us improving. You'll start to see the benefits of those investments and performance showing through when the market starts to go back.

Longer term we will see some growth in this market place. More than half of the market is analog that will go digital. We do know over the longer period of time the market will shift to LTE. It's good to see that first that with the spectrum auctions has been well funded. It's well more than $7 billion raised in these spectrum auctions.

I know it's going to happen over time. It's not going to be in the next two to three years, but beyond that there's going to be an impact on Harris Corporation. I think we'll be prepared and well positioned to compete as that market shifts to LTE. Those are the dynamics that are really happening in that North American space that we're faced with, and we'll start to see some improvements over time.

---

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

Okay, and one last one. Within IT services, are there any other large poles in the tent, such as the NMCI contract over the next 12 months that we should keep an eye on?

---

**Bill Brown** - *Harris Corporation - Chairman and CEO*

Well, NMCI was a pretty long and tall pole in the tent. It was the vast majority of the profit in that IT space. As you know, we were either going to compete and win it at very low margins, or it was going to go away, and unfortunately it one away. We have no more revenue or profit coming in IT services from NMCI, but we do still see the year-over-year impact. As we look over the next couple of quarters or year, there's no single big IT service profit generator that looks anything like NMCI.

---

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

Okay, thank you.

---

**Bill Brown** - *Harris Corporation - Chairman and CEO*

You bet.

---

**Pamela Padgett** - *Harris Corporation - VP-IR*

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

---

**Operator**

Chris Quilty, Raymond James

---

**Chris Quilty** - *Raymond James & Associates, Inc. - Analyst*

Thanks, Bill. I think you guys wrapped up the draft RFP for the Manpack program late last month. Were there any surprises, puts or takes, on that process in terms of specifications or requirements?

---

**Bill Brown** - *Harris Corporation - Chairman and CEO*

No. I think what the Army is doing is prudently drafting objective and threshold requirements that allows a vibrant competition to occur on the objective requirements, and it incentives over time to invest a Company's own dollars to improve their offering to hit threshold requirements over time, like lower weight.

They are particularly interested in -- there's a number of dimensions -- its heat, its range, a lot of things, but weight is a very important factor. The objective requirement, if I remember right, was that 14.6 pounds; but clearly they want it to be a lot less than that. This has been something we are laser-focused on, and have been working on for a couple of years. We do see opportunities to take weight down pretty substantially over the near term, and go below the objective requirements and actually perhaps even get better than some of the threshold requirements for weight.

No big surprise. One of the -- maybe a surprise was on the size of the ceiling value on the IDIQ at $12 billion to $12.7 billion. It's way above what we were thinking. Of course it includes services and spares and sustainment costs and a bunch of other things. It's well beyond the opportunity set in front of Harris, but still at that north of $12 billion is quite an impressive top-line ceiling value number for the Manpack, Chris.

---

**Chris Quilty** - *Raymond James & Associates, Inc. - Analyst*

Got you. To quantify, with the Rifleman program, that was originated as a Army program. When you look at the value of that contract, does that expand beyond the Army in terms of other services? I guess the same for the Manpack. Right now you've got customers at SOCOM, Navy, Air Force buying Manpack, and I believe those are funded separately?

---

**Bill Brown** - *Harris Corporation - Chairman and CEO*

Yes, in fact, we -- interestingly, the Manpack, the multi-channel Manpack that was developed to developed to compete for Army procurements is being sold outside of the Army within DoD first. We'll sell the Manpack within the Army, provided we win a position on the IDIQ over the next several years. We are already selling the MCMP outside of the Army.

On the Rifleman, it's starting off as a single-channel radio, but interestingly SOCOM is a two-channel radio. I would expect that as the Army introduced a potential two-channel into the Rifleman competition, that whatever is being sold into SOCOM could eventually work its way into regular Army over time. I see more of that shift happening, as opposed to from Army out, at least from the way I would see it today.

---

**Chris Quilty** - *Raymond James & Associates, Inc. - Analyst*

To clarify, those changes or increments would be inclusive of the $3.3-billion to $3.9-billion contract as it stands today?

---

**Bill Brown** - *Harris Corporation - Chairman and CEO*

My understanding is at the ceiling value of $3.9 billion on the Rifleman it would include a transition to a two channel over time. But again, what the acquisition objective is going to be restated to be, what's the mix of a single channel, two channel, is still to be determined. We'll know more about that as the Army really starts to re-think the way they want the network to be, given a lot of technology changes. I think the same thing is probably going to happen on the Manpack.

When I step back and I look at the size of where the Rifleman is at almost $4 billion, and the size of Manpack at north of $12 billion, so $16 billion to $17 billion worth of ceiling value between these two contracts, it's far above I think the opportunity set over 10 years for Harris.

Another way to look at this is just looking at what's in the President's budget four, five years out at close to $0.5 billion per year for HMS, which is Rifleman and Manpack, if you just took that over a 10-year basis -- $5 billion in terms of opportunity sets -- that's in line with what we had thought before about the opportunity for Harris in terms of HMS, both Manpack and Rifleman. Again, that's speculation on my part, but that's the way I would look at sizing the overall opportunity for the Company.

---

**Chris Quilty** - *Raymond James & Associates, Inc. - Analyst*

You haven't mentioned it in a while, but you've also seemed to have made some good progress with regard to some of the airborne programs that are all getting reorganized?

---

**Bill Brown** - *Harris Corporation - Chairman and CEO*

Yes, well we have a fantastic offering in the STT, the Small Tactical Terminal with ViaSat, which has Link16 and UHF/VHF capabilities. The team at GCS is doing a very good job in selling that product. The Army is evaluating whether they move forward with what they are calling a SALT, the Small Airborne Link16 Terminal competition. I think they're supposed to decide some time this summer, which would have Link16 with SRW in it. We'll have a play in that, if the Army goes in that direction. That's still to be determined.

The other one that's on the drawing board is SANR, which is the small airborne networking radio, which is SRW and WMW. I think the Army is still evaluating that. I think I saw in the President's budget -- I don't know if it's in the House Armed Services mark-up, but a small amount, like $6 million, to push forward that competition on SANR. We'll see when the budgets are actually set if that's happening, but if there is a small amount of money that would be an encouragement that the Army is moving forward putting SRW and WNW into a SANR product for the airborne side. If that happens, I do think we're going to be very well positioned to compete there.

Also, quite frankly with Exelis, with the ARC-201 product that they have, there's an opportunity to actually put some of our own technology into that box, if you will, and offer greater capability for the airborne tier, as we combine ourselves with Exelis. There's a lot of different ways of looking at how we might be able to extend our strong presence on the ground to the airborne tier.

---

**Chris Quilty** - *Raymond James & Associates, Inc. - Analyst*

To clarify, these are again collectively $2-billion incremental programs?

---

**Bill Brown** - *Harris Corporation - Chairman and CEO*

I don't think that they're going to be billions of dollars. I don't know the exact number, Chris. They're still deciding whether to move forward with these competitions. I think the jury is out. Last I had seen was SANR was sized at something like $600 million, and SALT was sized at something like $200 million, but it could grow over time, depending upon the platforms it gets put on. Could it be $1 billion? Maybe. Again, I think we need to wait until we see exactly how the Army wants to move forward with those two programs.

---

**Chris Quilty** - *Raymond James & Associates, Inc. - Analyst*

A billion here, a billion there. Pretty soon you're talking about real money.

---

**Bill Brown** - *Harris Corporation - Chairman and CEO*

Well, yes. In terms of not just there, but also what we've seen on the ground side as well, Chris. There's lots of big opportunities for Harris -- again, multi-billion dollars worth of opportunities over the next 10 years for our Company.

---

**Chris Quilty** - *Raymond James & Associates, Inc. - Analyst*

Great, thank you.

---

**Bill Brown** - *Harris Corporation - Chairman and CEO*

You bet, Chris.

---

**Pamela Padgett** - *Harris Corporation - VP-IR*

Okay, thank you everyone for joining us. I think that wraps us up for today.

---

**Operator**

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