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HRS - Q4 2015 Harris Corp Earnings Call

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OVERVIEW:

Co. reported FY15 non-GAAP EPS of $5.14 and 4Q15 non-GAAP EPS of $1.32. Expects FY16 revenue to be $7.67-7.83b, GAAP EPS to be $5.25-5.45 and non-GAAP to be $5.60-5.80.

CORPORATE PARTICIPANTS

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Bill Brown *Harris Corporation - Chairman and CEO*

Mick Lopez *Harris Corporation - SVP and CFO*

CONFERENCE CALL PARTICIPANTS

Gautam Khanna *Cowen and Company - Analyst*

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Harris Corporation fourth-quarter 2015 earnings conference call.

(Operator Instructions)

As a reminder this call may be recorded. I would now like to introduce your host for today's conference, Pam Padgett, Vice President of Investor Relations. Please go ahead, ma'am.

Pam Padgett - *Harris Corporation - VP of IR*

Thank you. Good morning, everyone, and welcome to our fourth-quarter FY15 earnings call. I'm Pamela Padgett and on the call today is Bill Brown, Chairman & 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. The reconciliation to the comparable GAAP measures is included on the Investor Relations section of our website, which is www.Harris.com. A replay of this call also will 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*

Thank you, Pam, and good morning. Our fourth quarter was productive for Harris and we ended the year with solid results. Harris stand-alone revenue and earnings per share met expectations. And free cash flow was stronger than expected, at 119% of non-GAAP net income, exceeding our goal of 100%.

A significant accomplishment in the quarter was closing the Exelis acquisition on May 29, a bit sooner than expected, and allowing us to accelerate a few key actions and speed up the pace of integration. On the day of closing, we consolidated headquarters activities between Harris and Exelis. On July 1, we announced our new organizational model, creating four market-focused segments and combining the top talent of both companies. And then two weeks later, on July 15, we announced our intent to close Exelis' Fort Wayne tactical radio facility and consolidate production in our world-class Rochester manufacturing operations. So we're off to a good start, and we'll provide a little more color on our integration efforts during the call.

At the end of the quarter, we closed on the sale of our commercial healthcare business to NantHealth, providing the business the domain expertise and channel leverage to allow it to reach its maximum potential. As we've expressed before, the Exelis acquisition provides us a unique opportunity for portfolio-shaping actions. And, in the context of our now larger combined Company, we'll continue to take a dispassionate view in evaluating what businesses are strategic and which are better served under a different owner.

Turning now to our financial results on slide 4 of the presentation, Harris earlier today reported non-GAAP earnings per share of $1.32 in the fourth quarter and $5.14 for the full year, both of which include a $0.09 benefit from one month of ownership of Exelis. Excluding the impact of Exelis' operating results for the month of June, non-GAAP Harris stand-alone earnings per share was $1.23 in the fourth quarter and $5.05 for the full year, with full-year revenue down 4%, all in line with prior guidance and reflecting good operating performance.

In the fourth quarter, higher revenue and continued margin strength for both RF Communications and Government Communications was more than offset by the anticipated weakness in Integrated Network Solutions. Orders for Harris standalone were $1.28 billion, up 17% over the prior year, and significantly higher in RF Communications and Government Communications. Book to bill for the quarter was just above 1, and for the full fiscal year was 0.98.

Strategically, we continued to increase our international footprint and invest aggressively in Company-funded R&D to position the Company for future growth. International revenue was up 2% in the quarter and 4% for the year, increasing as a percentage of total revenue from 30% last year to 32% this fiscal year.

And we increased our investment in IRAD as a percentage of total revenue to 5.7% this year, compared to 5.3% in FY14 and 4% just three years ago. I was particularly pleased with our free cash flow results, coming in about $100 million above what we were guiding on a Harris stand-alone basis due to continue tightening of capital spending and improved working capital performance, including higher accounts payable.

Before turning it to Mick to go through the details of the financials, let me offer a few high-level comments on the segments. Revenue at RF Communications was up 2%, driven by a 5% increase in Tactical and a 4% decline in Public Safety. Within Tactical, continued strength in international more than offset a decline in the US, which was a little lower than expected as a result of orders from two customers, totaling $28 million, taking a little longer to finalize and missing the quarter cut. The majority is now booked and shipped. Regardless of the slip, back half for Tactical came in at a solid 6% growth, with Q4 book to bill of 1.1, and 0.94 for the year.

In the international Tactical market, the highlight was a five-year, $55-million order from Australia for technical and logistics support to ensure combat readiness of our JP 2072 Phase 2 products that we previously shipped, bringing orders to date in Australia to more than $700 million. This latest win further strengthens our partnership with the Australian Defence Force and helps position Harris for Phase 3 of the country's multi-year battlefield communication modernization program that represents a $750-million opportunity that sits outside of our 12- to 18-month pipeline.

In the US Tactical market, we saw continued momentum for Army monetization. As you know, early in the fourth quarter, we were awarded a 10-year, $3.9-billion IDIQ contract for the Rifleman Radio, and by late July we completed qualification testing with the customer. On the much larger manpack program, the final RFP was released on August 3, a bit earlier than the September time frame we previously expected, with bids due in 60 days for what will be a very sizable 10-year, $12.7-billion multi-vendor IDIQ contract.

The Army now intends to award up to three IDIQ contracts in December, followed by qualification testing in March and customer testing in mid-summer 2016, with full-rate production delivery start dates in the first quarter of our FY18 -- pretty much as we expected. The published acquisition objective is for 65,000 radios. And I continue to believe that we're well positioned to capture a significant portion of this multi-year, multi-billion-dollar opportunity.

And then, finally, our mid-tier MNVR radio for the Army completed limited user testing at NIE 15.2, the significant milestone towards full-rate production. LRIPS are expected to follow, with operational test and evaluation at NIE 16.2 and a full-rate production award in September of 2016. MNVR should begin to ramp in FY16 and, together with Rifleman Radio, should become a more significant revenue contributor and drive good growth for US tactical in 2017 and beyond.

Revenue in Government Communications was up 1% in the quarter and 3% for the year, which is an excellent result, given the environment. Major growth drivers for the year included our large classified win in geospatial imagery, called Foundation GEOINT content management; continued ramping of F-35; wireless products; satcom terminals and high-band networking radios for the Army; and mission radios for the airborne market.

I'll also quickly highlight a new strategic partnership with exactEarth that we announced in Q4. exactEarth is the market leader in satellite-based, remote-ship tracking. And, in the fourth quarter, we received a $55-million order to place 58 commercially hosted payloads on the Iridium NEXT constellation to refresh the exactEarth network. This is the same satellite platform that hosts Aireon and other payloads in which Harris has the prime role, and it's a good strategic win for our team.

Let me now turn it over to Mick to provide some greater detail on our results and our FY16 guidance. Mick?

Mick Lopez - *Harris Corporation - SVP and CFO*

Thank you, Bill. And good morning to everyone. Slide 5 provides a detailed reconciliation of GAAP to non-GAAP and to Harris stand-alone non-GAAP earnings, highlighting $281 million in one-time deal and integration costs in FY15, which is in line with the $270 million to $290 million in our prior guidance. We also incurred additional charges in Q4 of a net $32 million for restructuring and other items impacting Harris stand-alone business, with the largest part being an intangible impairment in Integrated Network Solutions for the NMCI contract. Excluding $0.09 per share contribution from Exelis in Q4, Harris full-year EPS was $5.05.

On slide 6, we provide further detail on our ending cash balance and capital expenditures, which at $148 million for FY15 include $4 million for legacy Exelis. Our tax rate for the quarter and the year was as expected, ending the year with a non-GAAP tax rate of 30.2%. The favorable FY15 rate, which we don't expect to repeat in FY16, resulted from foreign tax credits, the R&D tax credit, and other FY14 tax settlements.

Moving to segment results on slide 7, RF Communications orders in the fourth quarter were $530 million, compared to $361 million in the prior year. And revenue was $505 million, compared to $493 million last year. Tactical Communications revenue was $366 million and increased 5%, while orders were $402 million. In Public Safety, orders were $128 million and essentially flat compared to prior year of $129 million. Revenue was $139 million, compared to $145 million last year. Non-GAAP operating income was $159 million, excluding restructuring charges related to Public Safety. Non-GAAP operating margin was 31.6% for the quarter and a strong 31.1% for the full year.

Turning to Government Communication systems on slide 8, fourth-quarter revenue was $485 million, up 1% compared to $480 million in the prior year. Higher revenue from the Foundation GEOINT content management program, the F-35 program, and high-band networking radios for the Army's WIN-T program was partially offset by lower revenue from two classified programs and the Navy's commercial broadband satellite program. Segment operating income was $66 million, and operating margin was 13.7% in the quarter and a strong 15.8% for the full year.

Turning to Integrated Network Solutions on slide 9, fourth-quarter revenue was $289 million, compared with $373 million in the prior year, a decline of 23%, primarily due to the wind down of two IT services programs and continued end-market weakness for both IT services and CapRock.

Non-GAAP operating income was $16 million, excluding charges related to restructuring and other items, compared to $33 million in the prior year, primarily due to the wind down of the highly profitable NMCI contract and continued weakness in commercial healthcare.

Moving to FY16 guidance on slide 10, today we're providing high-level guidance on revenue and EPS, with some color around FY16 expectations based on the legacy businesses of Harris and Exelis. Once we have pro forma historical information for FY15 recast into our four new segments, we will provide an outlook by segment, as we typically do. We're initiating guidance for GAAP EPS in a range of $5.25 to $5.45. And for non-GAAP, in a range of $5.60 to $5.80. FY16 non-GAAP EPS excludes about $60 million to $65 million of integration costs and a $10-million charge related to inventory step up. It includes about $133 million, or about $0.70 per share, of Exelis acquisition intangible amortization.

FY16 non-GAAP EBIT margin is expected to be in a range of 16.2% to 16.7%. Putting aside for a minute the cost synergies and other impacts related to the acquisition, guidance reflects segment-level operating margins for legacy Exelis slightly lower than the prior-year fiscal pro forma of about 12.5%. Harris segment-level operating margin is expected to be about flat with the prior year, based on legacy RF continued margin strength similar to a prior year; a more normalized operating margin in legacy Government Communications of about 15%; and for IT services and CapRock together, an operating margin of around 9%.

Other P&L guidance details are outlined on slide 10. I'll start with an update on expected synergy savings and integration costs. Our integration team has moved aggressively to capture cost synergies, and is ahead of schedule. As a result, both integration costs and savings are occurring sooner than what we previously expected.

We are now on track to achieve FY16 savings of $70 million to $75 million and expect to be at an annual run-rate savings of $120 million as we exit FY17, a year sooner than our original estimate and at the top end of our prior range. The $120 million in savings is net of savings that will flow immediately back to the government. Integration spending was $112 million in FY15 and we expect another $60 million to $65 million in FY16.

Total integration cost is now expected to be $150 million, the higher end of our prior range and net of about $25 million of expected reimbursements from the US government, which are not anticipated to begin until FY17. As we move toward greater standardization in processes, policies, and operations, we will continue to look for opportunities for further integration savings.

Revenue is expected to be in a range of $7.67 billion to $7.83 billion, down 3% to 5% on a pro-forma basis compared with a FY15 of $8.07 billion. Legacy Harris is expected to be down 2% to 4%. This reflects our initial expectations for Tactical Communications of flat to down slightly, with DoD flat to up low-single digits and international flat to down low-single digits, and continuing weakness in Public Safety, with a few percentage points decline.

In legacy Government Communications, we expect another growth year of up 2% to 3%. For IT services and CapRock together, we expect revenue to be down 13% to 15% as a result of continued end-market weakness.

Legacy Exelis pro-forma stand-alone revenue is expected to be down 5% to 6%, with lower revenue from night vision and communication products, and lower revenue from information systems, primarily from the $85-million roll-off of the Space Lift Range Systems contract that was lost last October.

Slide 11 provides some additional pension information, including an anticipated FAS pension income of about $25 million, and ERISA cash contributions of $173 million this fiscal year, with cash funding remaining roughly flat at $170 million in 2017 as a result of pension smoothing, provided for under the HAFA and MAP-21 legislation. Our unfunded pension liability has declined by about $200 million, to $1.9 billion at the end of FY15, principally due to the mandatory funding of the legacy Exelis SERP. The effect of modestly higher discount rates and lower expected return on assets largely offset each other.

So let me please turn it back to Bill for a few wrap-up comments before we open the call to questions.

Bill Brown - *Harris Corporation - Chairman and CEO*

Thank you, Mick. The revenue outlook that Mick just described anticipates continued budget constraints and a continuing resolution through the end of this calendar year. While the base budget, even under sequestered tax, is bottoming and is expected to slowly improve, the recovery will be gradual, with headwinds persisting until budgets improve and drive new program funding. In the meantime, we continue to have a robust, growing pipeline of opportunities, which is a positive sign for the future.

We also put in place an outstanding team leading the new organization we recently announced. As you see on slide 12, we've organized into four market-focused segments, and each segment's president is a well-seasoned executive in the government market -- Chris Young with 33 years; Carl DAlessandro with 31 years; and Bill Gattle and Ed Zoiss, each with 28 years. And we've taken our two most senior leaders, Sheldon Fox and Dana Mehnert, and focused them on driving greater cost and operational efficiencies, and re-igniting revenue growth across our Company.

I also believe we delivered on our promise to put the best of the best from both the Harris and Exelis organizations into the top jobs in the combined Company, with nearly half of the top 50 positions now filled by a former Exelis employee. I think the energy and enthusiasm across the entire Company is very high, with a lot of excitement about our future. So, as we enter the fiscal year at a running start on integration, and focused on exceeding our synergy goals and driving good earnings growth in 2016, with even higher accretion in FY17 and FY18

To conclude, on slide 13, we are executing very well on all critical integration success factors, from my deep personal ownership of the integration program to the full-time dedicated team led by Sheldon Fox that's driving a disciplined process with speed and precision, to the close oversight of the Board and the constant communication with employees. The result is that we are now at the high end of our prior range of run-rate savings, achieved about one year sooner than previously expected, with 90% of the actions underpinning the savings completed or in process in just 70 days since we closed.

I'm really proud of what Harris has accomplished this past year, and I'm optimistic and confident about what our new team of over 23,000 dedicated employees can deliver in the future. Together we're committed to solving our customers' most complex challenges and driving value for our shareholders.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Gautam Khanna, Cowan and Company.

Gautam Khanna - *Cowen and Company - Analyst*

I had a couple questions. First, Bill, I was wondering if you could expand on your earlier comment about looking at things that could be non-core. If you could just talk about what your return metrics are for making that evaluation.

Bill Brown - *Harris Corporation - Chairman and CEO*

The first thing we're doing is we're looking very hard at what fits strategically or not. And we're also looking at what pieces perform well within our Company. And I think you've seen over the last couple of years our willingness to take on some tough challenges on businesses that either weren't strategic or core to our Company or offer good returns to our shareholders. And I think we've made decisions that add value to our shareowners, and we'll do the same thing going forward. We really don't have anything more today to report, Gautam, but we continue to look at the portfolio and we will let shareholders know and you know as we make decisions.

Gautam Khanna - *Cowen and Company - Analyst*

Okay. Could you talk a little bit about the pension at Exelis. I know in the slide you mentioned the $170 million minimum payment this year. Do you have plans underway to minimize that cash payment as we move forward? Any different approach to the Exelis pension problem that you can talk about?

Mick Lopez - *Harris Corporation - SVP and CFO*

Yes, certainly we can talk about that. A lot of work has been done on the pension in the past. As you may know, in 2011 the pension was frozen to new hires. In 2011 there was an enhanced defined contribution plan that decreased participants. In 2012 they had a lump sum program that decreased another amount of participants.

Looking forward, we're taking an approach of obligations not just for the pensions but also for some of the other obligations we have out there. And we're looking at certainly derisking the asset portfolio, which is a concern, in order to have more traditional investment matching to the liabilities. But looking at the obligations, we have to stratify the pension years and future pension years, and be able to offer lump sum, so we're looking at some of that for the term vested and a traditional approach.

So, right now we have a comprehensive study going on. We're using consultants and actuaries to determine what is the best course of action going forward. But we will take an approach towards the pension both on the asset side and on the liability side to derisk it and to lower the obligations.

Gautam Khanna - *Cowen and Company - Analyst*

Okay. And, last one, sales synergies -- can you talk about any opportunities that you're seeing that are contemplated in the guidance or not? Does it include any sales synergies, or have you seen any --?

Mick Lopez - *Harris Corporation - SVP and CFO*

First of all, it does not include any sales synergies. Right now we're focused on the cost side. I think we got out of the gate very quickly. As we've talked before the deal was justified on cost savings not revenue upside.

We clearly do see revenue opportunities over time. We have a very good team focused on that. We're organized in a way to go and capture some of the revenue upside by the four market-focused segments.

I think, importantly, we put one of our most seasoned executives that you know well in Dana Mehnert on top of global business development. One of his key responsibilities is to identify and go out and capture some of those revenue opportunities between the companies. It's something we will say more about over the course of FY16, maybe not next quarter but certainly over the course of the year.

Gautam Khanna - *Cowen and Company - Analyst*

Congratulations on the great results. Good luck.

Operator

Seth Seifman, JPMorgan.

Seth Seifman - *JPMorgan - Analyst*

Good morning and congratulations on a successful transaction. I was wondering, as you look ahead, and I know it's obviously very early to start talking about what might happen beyond next year, but when do you think about the overall Company, and maybe Exelis, specifically moving to top-line growth?

Bill Brown - *Harris Corporation - Chairman and CEO*

We're entering a FY16 where we still have some friction in the system with the government budgets. We do expect a CR to go through the balance of the year. It could extend beyond that. We'll over the next several months as to what's happening in DC. And that does put some challenges in our business and certainly with Exelis, as well.

But we do see, even under sequester budgets, budgets improving in FY17, FY18. I'm very encouraged that we are seeing some of the modernization spending on tactical radio start to move. I feel good about where we're at on Rifleman. I'm really good to see the manpack RFP come out a couple of days ago. I'm glad to see they're moving quickly with a 60-day proposal time period and expecting to make awards in December if all things go smoothly in negotiations.

So, these, I think, are good signs that there's money moving or will move over time. And I do feel pretty optimistic that that will allow our Company to grow maybe not next year but certainly in the years beyond that, Seth. Thank you.

Seth Seifman - *JPMorgan - Analyst*

Thanks. And maybe just as a quick follow-up, on the international radios, you talked about maybe being flat to slightly down next year. If you could just talk about anything shifting in terms of the regional dynamics. And I know you mentioned the Australia opportunity that comes beyond the pipeline portfolio, but anything that's shifting in the portfolio and in the pipeline. And if there's any trajectory to the outlook beyond this year for international radios.

Bill Brown - *Harris Corporation - Chairman and CEO*

Sure. The international business for us is, as you know, has been very strong and we ended the year in Q4 very strong. The orders were extraordinary. I'm very glad to see the revenue was up for the full year. It was up at the high end of what we were guiding to, nearly 10%. So we feel very good about where we ended the year.

The pipeline is still pretty robust at about $2.4 billion. Last quarter it was $2.5 billion. I wouldn't read a lot into that, it moves around a little bit from time to time. But it's still very solid at $2.4 billion.

The shape of the pipeline looks pretty much like it has over the last couple of quarters. More than half of it is in the Middle East, Northern Africa, Central Asia. And that does seem still to be pretty robust, though we do see in the Middle East, in two specific countries, some stretch out of some opportunities which we believe over time are very big for the Company. One is in Iraq and the other is in Saudi Arabia.

In Iraq certainly the price of oil with WTI shifting just a little bit below $45 a barrel, that's causing some impact on direct commercial sales. We do know that Iraq sales for us are back stopped by US government foreign military funding. But there are some new commanders in Iraq and that's taking a bit slower for some of those sales into Iraq to take place. So, Iraq is slipping at little bit.

And then Saudi, oil is causing a little bit of a problem there. There's a new leadership team in Saudi Arabia. And certainly the strife in Yemen is causing some shifting around of priorities.

Those are the two things that have shifted a little bit further to the right. We do see multi-year opportunities in the hundreds of millions of dollars in both Iraq and Saudi Arabia. So, we feel good about those.

Australia is very strong for us. I mentioned in my remarks a $750 million phase 3 opportunity that's outside of our pipeline but it's real. We're participating in that and that's going to end up happening.

So longer term, we do see good opportunities in international. If you recall at the beginning of FY15, we started international tactical with relatively modest guidance of up low single digits and we ended up at about 10%. And I hope going into FY16 we are being similarly conservative.

Seth Seifman - *JPMorgan - Analyst*

That's great color. Thank you.

Operator

Pete Skibitski, Drexel Hamilton.

Pete Skibitski - *Drexel Hamilton - Analyst*

Bill, just on the prior target of $1 billion in free cash by year four, can you update us? Are you sticking with that? And what year should we think of as year four at this point?

Bill Brown - *Harris Corporation - Chairman and CEO*

Year four will probably go out from four years when I first made the comment, so I wouldn't want to accelerate that from here. But I still feel confident on the a billion of free cash flow. When I look at just where we happen to be guiding this year at more than 100% of adjusted GAAP net income, excluding amortization, the after-tax amortization, when you run the math on that it's in the $750 million range with a lot of moving parts, and we're just getting started.

You add on top of that run rate savings, some improvements of working capital, some more tightening down on capital spending and other things, and I do see that over the next three, four years we could definitely get to a billion of free cash. So, no, I'm not backing off that target.

Pete Skibitski - *Drexel Hamilton - Analyst*

Okay. And then just on capital deployment, it looks like you're turning off the repurchase program, at least for this year. Is that right? And then maybe what's the right level of debt paydown to factor in this year?

Bill Brown - *Harris Corporation - Chairman and CEO*

Yes, that's has we had signaled before. Our number one priority outside of funding our own internal requirements, which of course is embedded in free cash flow, and making sure that we continue to pay an attractive dividend, beyond that our number one priority is debt paydown. And that's what we're going to do. It's important for us to delever.

We still have the targets out there going from 2.9 times net leverage to 1.5 over the next three years. And that's our number one priority. So, for the course of FY16 in our current guidance we have assumed no share buyback.

Pete Skibitski - *Drexel Hamilton - Analyst*

Okay, got it. And then just last one, maybe more for Mick -- the deal amortization of $133 million, is that the same level in 2017 and 2018, or does that run off pretty quickly? And can you help us with how it loads across the quarter for 2016?

Mick Lopez - *Harris Corporation - SVP and CFO*

Yes, sure. Of the $1.6 billion about $1.4 billion is in customer relations. The rest is in technology, trademarks, grants, and so forth. But there's a little bit which is for the Exelis brand, and that gets amortized over two years. So we'll expect to have $133 million for the next two years and then it's $125 million or a little bit less in the others.

Pete Skibitski - *Drexel Hamilton - Analyst*

Okay, thank you.

Operator

Josh Sullivan, Sterne Agee.

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

What kind of impact does a quarter point raise in interest rates have on the pension obligation?

Mick Lopez - *Harris Corporation - SVP and CFO*

The sensitivity for a quarter point -- and there's convexity here -- 25 basis points up is a decrease of $171 million, and 25 basis points down is an increase of $208 million on our liability. On the income, 25 basis points, it's about $8 million. Does that answer your question?

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

Yes. That's helpful, thank you. And then just on the healthcare divestiture, how much was it losing a year? And then did you receive any compensation for the transaction?

Mick Lopez - *Harris Corporation - SVP and CFO*

We did. And you'll see in the tables that we are presenting, and you'll see in our K, that we received about $43 million net cash in, in the fourth quarter for the sale of healthcare. The transaction was about $50 million. There's some that's sitting in escrow. The cash in was about $43 million.

It gave us a pretax gain in the quarter of about $8 million. So, when you look at a year-over-year basis, it's worth about a $12 million delta between FY15 and FY16 in terms of the healthcare impact.

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

Okay, thanks.

Operator

(Operator Instructions)

Pete Skibitski, Drexel Hamilton.

Pete Skibitski - *Drexel Hamilton - Analyst*

On the segment guidance, the updated segment guidance, do you contemplate issuing and 8-K intra-quarter with the pro formas or was there some other plan there?

Bill Brown - *Harris Corporation - Chairman and CEO*

We've got a lot of work to do here on just restating the historicals. I would say that -- I'm looking to Mick -- but I think we will be able to provide outlook guidance and segment historicals restated certainly in our Q1 release. We can't commit today that it will be any sooner than that but it will be, at the latest, at our Q1 release.

Mick Lopez - *Harris Corporation - SVP and CFO*

You're absolutely right, Bill. We're working to finish the K and we look forward to resegmenting and providing the information to you as soon as possible.

Pete Skibitski - *Drexel Hamilton - Analyst*

Okay, got it. And then on the $37 million -- I think it was $37 million -- restructuring at INS in the fourth quarter, is that a go-forward cost take-out for IT services and CapRock? Is that what's going on there?

Bill Brown - *Harris Corporation - Chairman and CEO*

Yes, there's a piece of it, about $19 million, that's, as Mick had mentioned, the write-down of an intangible associated with the NMCI contract that went away over the course of FY15. And that's about half of it. The balance is restructuring at CapRock.

Pete Skibitski - *Drexel Hamilton - Analyst*

Okay. And then, lastly, Bill, some of the other big opportunities -- the SOCOM STC and I think the Air Force had a big program and there was SANR -- anything looking like it's in the 12-month pipeline in terms of a potential award there?

Bill Brown - *Harris Corporation - Chairman and CEO*

Nothing in a 12-month pipeline. STC, we have a baffle win and the award is expected in September if they move on the path that they say they're going to move on. And that's on the two-channel hand-held. There's bigger programs going forward in the manpack and an HF radio that you will see RFPs on later than September. That's the current trajectory on STC.

And then SANR and SALT, they're going to make some decisions on these programs over the coming months, we believe. And it really depends upon what happens in the FY16 budget. But we currently are shipping our STT radios for what is considered the SALT at this small airborne link 16-terminal program. And we're already shipping our STT product in concert with ViaSat.

And on SANR, it's hard to say whether it's going to go. That's a WNW SRW two-channel radio for a bunch of military rotary aircraft programs. But I think they wouldn't expect any production awards on that until something like GFY19. So, it's pretty far out there in the future and it's not in our horizon.

Pete Skibitski - *Drexel Hamilton - Analyst*

Got it. Thank you very much.

Operator

Guatam Khanna, Cowen and Company

Gautam Khanna - *Cowen and Company - Analyst*

Bill, can you comment a little about how you're going to preserve profitability at the RF tactical business unit given -- you have some LPTA type bids coming up? So, if you were to win manpack, for example, presumably pricing will be under some pressure. And I just wondered if you could talk about some of the levers you have, be it R&D, year to year what are your expectations? And other factors?

Bill Brown - *Harris Corporation - Chairman and CEO*

First of all, I think the team has done a really outstanding job, not just in the last three years or over the last decade, in taking costs out of the product. And I've given some examples on prior calls on what the team has done on the 117G to take costs out every year post its launch. And I would see that we will be able to do the same thing as these new products start to come into the portfolio and mature.

At the end of the day we've got probably the largest tactical radio facility in the world. It's going to become even more utilized as we bring in the tactical radio business from Fort Wayne. It's both the international and the DoD business running in the same facilities. It's 0.5 million square feet of world-class manufacturing. Huge supply chain leverage.

And on top of that we're spending, give or take, $100 million a year on tactical radio innovations, which I do believe will continue to put features into our products over time, which will allow us to continue to drive what we hope to be premium price versus our competitors. I think all of those things will allow us to maintain our margins in tactical, and that's what we certainly expect at Harris.

Gautam Khanna - *Cowen and Company - Analyst*

Can you help size the MNVR opportunity, what it's been running at, and where you think it's going to go on an annual run rate basis?

Bill Brown - *Harris Corporation - Chairman and CEO*

It's been about $10 million or $15 million over the last year or two. I think we booked between $15 million and $20 million worth of orders or thereabouts. We expect in FY16, Gautam, about $20 million worth of revenue, and it'll ramp and little bit beyond that, probably up maybe two or three times beyond into FY17.

Again, it depends on what happens as to when they issue the full rate reproduction award, how they want to field it. Because that's changing a little bit in some of the BCP changes that are happening in the Army. As that settles down, we do know that 2017 is going to ramp from 2016, and we think 2016 is around $20 million of revenue, more or less.

Gautam Khanna - *Cowen and Company - Analyst*

Okay. And one last one -- if you could also just help size HMS manpack should you win it. I just wondered, you do sell some 117Gs now, and if you could just talk about cannibalization, if there is any, if you were to prevail on manpack.

Bill Brown - *Harris Corporation - Chairman and CEO*

First of all, on the manpack, it's not going to affect our revenue until our FY18. That's what we're thinking at the moment based on the schedule as we see it. If you look at just between Rifleman and the manpack, the PBR is about $0.5 billion per year for that HMS program. And over a decade that's $5 billion between Rifleman and manpack. And that's our best guess on a decade-wide opportunity.

Obviously our revenues can depend on our share of both Rifleman and the manpack. But it'll affect our FY18 revenue on the manpack, probably FY17 from the Rifleman.

In terms of cannibalization, we've given a lot of thinking to this, and we believe that it'll be mostly incremental to our base business today. Because it's being bought, the modernization is being bought by different parts of the service than what are buying the replacement Gs, spares and other things. So, our sense is that it'll be mostly incremental with not so much cannibalization, Gautam.

Gautam Khanna - *Cowen and Company - Analyst*

Okay, thanks a lot. I appreciate it.

Operator

Chris Quilty, Raymond James.

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

I haven't yet made it through the whole 689-page manpack solicitation, but can you comment on any puts and takes you see in the document relative to your design and competitiveness? And can you comment specifically on the proposal for the light version and how well you are positioned for that?

Bill Brown - *Harris Corporation - Chairman and CEO*

Yes, I didn't get through 689 pages, Chris, either, but we had a really good tactical team that summarized it brilliantly in 4 or 5 pages. Look, not much has changed from the very good dialogue and interaction we had with the Army during the draft RFP process. It was a couple of industry days.

As you know, this has been percolating for quite some time. There's been a lot of active dialogue, a lot of conversation on range, power, weight. Is it radio weight, mission weight? Is MUOS in, is it out? There's been a lot of puts and takes. At the end of the day, the final RFP is in line with what we had expected.

What I think is very interesting is that what they're going to do is look for, at the time of award you have to meet certain threshold requirements, and one of which is a 16-pound mission weight. They're going to give you some additional, if you will, leverage for MUOS and some antennas and other things. Then they have a deferred threshold set of requirements that have to be met by June of 2017. And then a series of objective requirements that will fold in over time based on how industry evolves to capture some of these opportunities -- again, like around power, weight, et cetera.

That's the way we see it shaking out. This whole light manpack opportunity is going to be interesting and I don't know where it's ultimately going to go. They're looking for a lower weight manpack. It maybe feature some of the manpack. It could potentially, Chris, be something like a two-channel hand-held that would go to SOCON and maybe over time go into the regular Army.

So, we're unclear as to how that's going to evolve over time. But that's essentially the way we see 689 pages in a nutshell.

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

Thanks. And with regard to the 13% to 15% decline in IT services and CapRock, could you break it out between the businesses and comment specifically on where you see the CapRock, the energy, business trending relative to where you thought it would be six months ago?

Bill Brown - *Harris Corporation - Chairman and CEO*

Sure. On IT services, we see down about 15%. We see CapRock as a whole down about 10%. And in CapRock down about 10% we're seeing the energy business down about 20%.

Let me just give you a little color on this. Back in Q2 and Q3 the orders were quite good. We did expect the second-half revenue in CapRock to turn down, and it in fact did. We came in spot on what we thought we would be in terms of the CapRock revenue for the year. We were down in Q4 about 13%.

Of course we're seeing now price of oil just below $45. There's a potential deal, there's a RAND issue that could drop price of oil down even further. We've calibrated going forward for CapRock energy in FY16 down about 20%.

We did see in the last quarter a lot of the oil majors, oil service companies have done more restructuring. Rig count is down globally, around 36%. We think we've calibrated for current events in CapRock being down about 20% next year. But, again, we are watching very carefully what is happening to the price of oil, but, more importantly, the behavior of our major customers in response to the price of oil. And we're simply reacting to what they're doing.

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

Great, thank you very much.

Operator

Noah Poponak, Goldman Sachs.

Noah Poponak - *Goldman Sachs - Analyst*

Bill, what are the prospects for eventually moving above the $120 million synergy run rate? It's obviously quite impressive that you were able to move it forward a full year in such a short period of time. But how much is this is you had identified everything and have just been able to do it much faster versus finding new things or there being potential to find a lot more opportunity to go even higher than $120 million?

Bill Brown - *Harris Corporation - Chairman and CEO*

First of all, Noah, our diligence was very good. And we're finding that most of the opportunities that we thought we would capture we have captured. And not much has changed. We knew right out of the gate the first things we would attack would be the public company costs and we did that right out of the gate. We knew there was an opportunity on the tactical radio side between the two facilities that we had and we went at that very quickly.

So, most of the things that we had anticipated we're executing on. As I said, about 90% of the actions that we contemplated going after $120 million are completed or in process, so we feel pretty good about that. But, as I said, we're 70 days in and we're at the high end of the range we gave before.

As we go forward, we continue to find new opportunities. Will there be some things that work against us? Sure, without a doubt. But I do believe that we have a good opportunity to continue to drive it above $120 million. Today our best guess for where we stand today is $120 million.

Noah Poponak - *Goldman Sachs - Analyst*

Okay. And the cost to achieve synergy that I believe was previously outlined as $130 million to $150 million. Has that moved? I'm not 100% sure that I'm squaring that up with slide 10.

Bill Brown - *Harris Corporation - Chairman and CEO*

Let me give you some color on that. First off, the $120 million on the savings, as Mick had mentioned, we reimbursed the government directly in the year immediately on the $120 million. On the cost to achieve it was $130 million to $150 million. That was net of expected government reimbursements. And that was going to happen over a two- to three-year time period.

We had $112 million worth of integration and project costs hit us in FY15. We have another $60 million to $65 million hit in FY16. You put them together it's about $175 million. We do expect about $25 million reimbursement by the government sometime in FY17 or beyond. And that's what gets us to the $150 million.

Noah Poponak - *Goldman Sachs - Analyst*

I see. Okay. That's helpful. And then just to follow up on that CapRock question, down 20 is not insignificant, but you mentioned what rig count has done, and it's more. And you mentioned what the actual fuel price has done, and it's more. What is it about CapRock that would make it outperform the broader industry?

Bill Brown - *Harris Corporation - Chairman and CEO*

It's really the mix of the rigs. When we say rig count is down 36%, that's land, that's near offshore, it's deep offshore, ultradeep. And because the assets, the value, of deep offshore rigs are so great for the oil companies, they tend to stay in production longer.

We are more disposed to offshore and deep offshore. That's where the revenue happens to be. So even though rig count is coming down, like on land, quite a bit more than 36%, not a lot of revenue for CapRock going into the land side. A lot more on the offshore and deep offshore.

Noah Poponak - *Goldman Sachs - Analyst*

I see. And then any color or comment you could provide on what potential you see in the legacy Exelis business base margin beyond this year? Should we think of that as pretty flattish over time? Or is there opportunity for that to change? Or does it have headwinds going forward?

Bill Brown - *Harris Corporation - Chairman and CEO*

It's coming down slightly in FY16 from 2015 and that's partly due to the revenue coming down a little bit. We're guiding to down 5% to 6%. When you go back to the old segments of Exelis we do see the electronic systems and the night vision comms business both being down in FY16 about mid single digits.

The IS business, information systems, will be down about 10% with the largest piece of that 7 or 8 points, roughly. That's from the loss of a contract, a range support contract, that was lost in October of last year. We do see the aero business up mid teens. It's growing pretty nicely with content with Boeing, with Airbus, with the F-35 ramp, the 53K with Sikorsky. They've got some good programs there.

When I look at all of the pieces and how they're moving around and what's growing, the aero business does have lower margins, so when that grows faster than the others it does depress the overall margin rate a little bit. But I do see that there is some softening in the margins for night vision comms. And I do see some softening in the electronic systems business as they transition from what were production programs to some more development programs. And that's a natural transition. They were down, I think they were at about 12.5% pro forma last year, if I remember right, and we're guiding to be slightly less than that in FY16.

Noah Poponak - *Goldman Sachs - Analyst*

Okay, thanks very much.

Operator

Pete Skibitski, Drexel Hamilton.

Pete Skibitski - *Drexel Hamilton - Analyst*

I just wondered if you had a funded backlog at year end for Exelis. And then, Bill, Exelis has had some top-line headwinds for a long time. The question of when the trough would come is still out there. Do you have a sense for when all these programs trough for Exelis?

Bill Brown - *Harris Corporation - Chairman and CEO*

Somebody is grabbing the funded backlog. I think it ended at around $2.5 billion -- $2.4 billion, $2.5 billion -- just under $2.5 billion on funded backlog. But there's a lot of programs here, Pete, in Exelis, there's a lot of moving parts. I think we've tried to take a look across all of them and make our best assessment to where the revenue is on, if you will, a pro forma Exelis business into FY16. And, again, we see that down about 5% or 6%.

I provided a little bit of color by each of the segments. I don't think I'll go out any further than 2016, as I wouldn't do for the core business either for Harris. But that's basically where we stand on the revenue outlook for Exelis. Do you have the backlog here, Mick, handy?

Mick Lopez - *Harris Corporation - SVP and CFO*

I have the year-to-year total backlog was down 15%. The funded was down 17%. The orders were weak in the quarter. Of course, it's hard to gauge how much of that weakness was due to the disruption.

Pete Skibitski - *Drexel Hamilton - Analyst*

Thanks, guys.

Pam Padgett - *Harris Corporation - VP of IR*

Thank you very much, everyone, for joining us. And let me know how I can help. Thank you.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This does conclude today's program. You may all disconnect. Everyone, have a great day.