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HRS - Q1 2016 Harris Corp Earnings Call

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OVERVIEW:

HRS reported 1Q16 revenues of $1.81b and non-GAAP EPS of $1.31. Expects FY16 revenues to be $7.67-7.83b and GAAP EPS to be $5.25-5.45.

CORPORATE PARTICIPANTS

Pamela Padgett *Harris Corporation - VP of IR*

Bill Brown *Harris Corporation - Chairman and CEO*

Sheldon Fox *Harris Corporation - SVP and Integration Lead*

Mick Lopez *Harris Corporation - SVP and CFO*

CONFERENCE CALL PARTICIPANTS

Pete Skibitski *Drexel Hamilton - Analyst*

Seth Seifman *JPMorgan - Analyst*

Steven Cahall *RBC Capital Markets - Analyst*

Gautam Khanna *Cowen and Company - Analyst*

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

Taye Scolia *Goldman Sachs - Analyst*

PRESENTATION

Operator

Good day ladies and gentlemen, and welcome to the Harris Corporation's first-quarter 2016 earnings call.

(Operator Instructions)

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

Pamela Padgett - *Harris Corporation - VP of IR*

Thank you. Hello, good morning everyone. Welcome to our first-quarter FY16 earnings call. I'm Pamela Padgett, and on the call today is Bill Brown, Chairman and CEO; Mick Lopez, Senior Vice President and CFO; and Sheldon Fox, Senior Vice President and Integration Lead.

Before we get started, a few words on forward-looking statements. Forward-looking statements made today involve assumptions risks and uncertainties that could cause actual results to differ materially from those statements. For more information and discussion of such assumptions, risks and uncertainties, please see the press release and presentation in Harris's SEC filings.

In addition, the reconciliation of non-GAAP financial measures discussed today to comparable GAAP measures is included on the investor relations section of our website, which is www.Harris.com, and where a replay of this call will be available. With that, Bill, I will turn it over to you.

Bill Brown - *Harris Corporation - Chairman and CEO*

Thank you, Pam, and good morning, everybody. Our first quarter with a solid start to the fiscal year, and was our first full quarter including Exelis's operations. Integration of Exelis is progressing well, with cost savings dropping through to results in Q1, and expected to ramp quickly through the balance of the year.

Coming out of the gate, I was very pleased with first-quarter order strength, particularly for tactical radios, electronic warfare and intelligence systems, which resulted in a book to bill of 1.24 for the Company and 6% sequential growth in funded backlog. And we're delivering on our commitment to delever paying down term debt by $150 million in the quarter, while continuing to pay an attractive dividend, which was increased in August for the 14th consecutive year.

Harris is now operating in four new business segments: communications systems, space and intelligence systems, electronic systems, and critical networks. In a separate filing yesterday, we provided historical pro forma information for FY14 and FY15, combining Harris and Exelis historical results, as if the companies had previously operated together, and under the new segment structure, information we believe is helpful for understanding year-over-year trends.

We'll refer to these comparisons as organic in today's call and presentation materials. I'll also remind you that all of our comments address non-GAAP results, excluding acquisition-related costs.

Turning to slides 3, 4 and 5 in the presentation, revenue in Q1 was $1.81 billion compared to $1.16 billion in the prior year, and was higher because of the acquisition. On an organic basis, revenue was down 6%, driven in large part by continuing weakness in the government and energy services markets. Earnings per share was $1.31, and included $0.17 of intangible amortization from the Exelis acquisition. Acquisition-related savings are reading through and improving operating income, with EBIT before amortization of intangibles up 7% to $319 million, and margin increasing more than 200 basis points to 17.6%.

Cost synergies were $11 million in the quarter, and were on track to reach our fiscal year target of $70 million to $75 million. Also captured in improving operating performance is our ongoing focus on what we call Harris Business Excellence, our operational excellence program, which targets 2% to 3% in annual net cost reduction. In addition to supporting margins, our strategy is to reinvest some of these savings into R&D and new product development to drive future growth. And in Q1, we continued to spend at a healthy rate of 4.3% of revenue.

Q1 orders were $2.24 billion, with book to bill of 1.24, and with all four segments greater than 1. In Harris's legacy tactical radio business, orders increased 30% and book to bill was 1.3, with strength in both US DoD and international markets. Our international tactical radio business continues to be supported by a pipeline of near and longer-term opportunities across a broad set of geographies, and driven by ongoing global security concerns.

From NATO responding to Russian aggression to conflict across the Middle East, central Asia, and Africa. In northern Africa, the US is gearing up to combat rising terrorism, and the tilt to the Pacific is providing significant multi-year opportunities in Australia.

And US funding support for foreign military sales remains strong, both in the base budget, as well as in the OCO accounts. OCO funding in GFY 15 and proposed in GFY16 is supporting several special initiatives like the European reassurance initiative, the counter terrorism partnership fund that supports regional regions of instability in the Middle East and Africa, and the train and equip fund for Iraq.

First-quarter tactical orders were underpinned by the strong US funding support, and included $38 million and $26 million from a country in Central Asia, $39 million from two Baltic countries, $27 million from several countries in the Middle East and Africa. Also progressing through procurement, are opportunities supported by the Iraq train and equip fund, with the first of these opportunities in the low tens of millions, and expected to book in Q2.

In the US market, our base business continues to be supported by reset opportunities in sustainment, which was reflected in 1Q's broad-based order strength across the services, and also included a $100 million single source IDIQ ceiling increase to $500 million for tactical radio spare part purchases by the Army and other agencies.

A very big strategic win in the quarter, which is currently under protest, is a $390 million SOCOM two channel hand-held tactical radio. This radio combines communication and ISR capabilities, and can receive full-motion video, as well as signals-based threat information. SOCOM is typically an early adopter of technology, so we're encouraged that continuing to invest our own Company-funded R&D is a winning strategy, supporting our already strong competitive position.

Similar to other products first developed for the US market, we fully expect this new two channel hand-held will generate strong international demand. This win is part of a larger modernization program that SOCOM has estimated could reach $900 million, and include a multi-channel manpack radio expected to be awarded in the fall of 2016, and a high-frequency radio expected to be awarded in the summer of 2017.

In addition to the SOCOM award, we're seeing other signs of momentum building for a broad-based US tactical modernization. In early October, we submitted our bid for the Army's two channel manpack radio, with award anticipated early next calendar year, and our MNVR Mid-Tier radio for the Army is slated for a Milestone C decision in the coming months.

In the airborne market, we have been selling Link-16 radios codeveloped with ViaSat by upgrade Apache aircraft, and with the SALT program now canceled, we will continue to be the sole provider for that mission. The more significant airborne opportunity on the horizon is the small airborne networking radio, or SANR program valued at $700 million, which had been pushed out by budgetary pressures. Funding for SANR has begun, and the first draft RFP is out, with the second expected in December. First production buys are currently expected to begin in GFY19.

We also had excellent wins from classified customers, receiving orders of $184 million, up significantly over the prior year, and primarily in support of advanced sensor systems and space superiority. With the pivot to Asia, space superiority and production has become a US defense priority, and recent reports suggest spending in this area could reach $8 billion over the next five years. We also saw nice recovery in electronic warfare orders, including slips from the prior quarter, with the wins coming from across the air, ground and maritime domains of our EW franchise.

In the air domain, we received orders of $111 million from the Air Force, primarily for the B-52, and $97 million from the Navy for the F-18. And we won a five-year $78 million single award IDIQ from a DoD customer for rotary aircraft. In the ground domain, EW orders included $27 million from the US Department of State for EGON counter IED systems.

And supporting the maritime domain, we were awarded three contracts: A $113 million contract with an initial $39 million order from the US Naval Sea Systems command for radar modification kits. A two-year $49 million production contract for sonobuoy launchers used to conduct underwater acoustic surveillance on 25 US and 8 Australian P-8 Poseidon aircraft.

And a three-year $54 million single award IDIQ from the US Naval Research Laboratory for the advanced decay architecture payloads program, or ADAP. The ADAP award is a strategic win. It allows us to enter a new market with the potential to grow longer term. Our solution provides capabilities to address advanced maritime threats, beyond what current decoys provide, and because our solution allows the customer to retrofit existing decoy shelves with our payload, it's cost effective and it's quick.

As you know, Sheldon Fox is leading our integration effort, and as we promised investors and the Board, Sheldon and his team are dedicated full-time to successfully integrating the two companies. So before Mick provides detailed results and guidance on the new segment basis, I've asked Sheldon to join us today to provide a status update and highlight one of our larger integration projects. Sheldon?

Sheldon Fox - *Harris Corporation - SVP and Integration Lead*

Thank you, Bill, and good morning, everyone. Our integration began with a running start at closing, and within the first 70 days, we had 90% of the actions underpinning the savings completed or in process. And we've continued along that aggressive path to quickly execute against our plan, and expect to generate between $70 million and $75 million in savings in FY16, well on our way to achieving the $120 million run rate savings as we exit FY17.

We're executing fast and executing with a great deal of focus. Each cost synergy project have a dedicated team, and detailed plan which is tracked weekly. Bill asked me to provide a little color on a key project which highlights the value we're creating through integration.

In July, we announced the closure of Exelis' Fort Wayne TASCO radio facility and consolidation into our world-class Rochester manufacturing facility. In the first quarter, the last SINCGARS radio rolled off the line in Fort Wayne, and all manufacturing operations will wrap up by fiscal year end. Currently, we're taking steps to ensure that engineering and manufacturing know-how is fully transferred to Rochester, including moving key employees.

Slide 6 shows the floor space in Rochester that has been designated and prepped for the transition. The reduction in manufacturing square footage for SINCGARS production is significant, reducing the footprint from 90,000 square foot to 20,000 square feet, and reducing six SMT lines down to two. The entire facility in Fort Wayne is about 300,000 square feet. Once SINCGARS is transitioned, we will shrink the remaining space being utilized to about 30,000 square feet, until the lease expires in December 2017.

Our actions will begin to produce savings in the fourth quarter of FY16, with additional savings to follow through optimizing our supplier base and leveraging the scale and efficiency of the Rochester facility. But why is all this important? Because SINCGARS remains an important communications capability around the world. The SINCGARS radio line has an installed base of 600,000 radios worldwide, with about 550,000 of those in the US.

In the domestic market, there is a very long tail of replacement and sustainment. So executing a seamless manufacturing transition will be important in supporting and eventually transitioning SINCGARS users to new JTRS radios. And in the international market, demand for SINCGARS radios is still fairly strong. While one of the larger initial projects, Fort Wayne is just one of the many projects in progress. Integration process will be a multi-year effort, and we're still in the early innings, but we're off to a terrific start.

Let me turn it over to Mick.

Mick Lopez - *Harris Corporation - SVP and CFO*

Thank you, Sheldon. Glad to have you on the call. Good morning to everyone. On slide 7, we provide descriptions of the new segments. The following segment slides show prior-year pro forma results, as if Exelis and Harris were combined for all of FY15. We believe this resulted in more meaningful year-over-year organic comparisons.

Moving to segment results, starting on slide 8. Communication systems segment revenue was $454 million, compared to prior-year pro forma revenue of $469 million. An increase in tactical communications was more than offset by weakness in public safety, where competitive pressures remain challenging. Within the segment, tactical communications has been redefined at the combination of both companies' ground and airborne technical radios, with Exelis night vision products. We have provided that detail in slide 8. On this new basis, tactical communications revenue is up 1%, primarily driven by a 7% increase in Harris legacy tactical, partially offset by lower expected revenue in Exelis legacy tactical, and night vision product lines.

In public safety, revenue was $92 million compared to $111 million in the prior year. Communication systems segment operating performance improved compared to prior-year pro forma. Operating income in the first quarter was $138 million and operating margin was 30.4%, compared to last year's operating income of $125 million and 26.7% margin.

Turning to space and intelligence systems on slide 9, first-quarter revenue was $435 million, compared to prior-year pro forma revenue of $455 million. Higher revenue from two classified programs, including the foundation GEOINT content management program, was more than offset by the completion of two other classified programs and a commercial space payload program. Segment operating performance improved compared to prior-year pro forma. Operating income in the first quarter was $68 million, and operating margin was 15.6% compared to last year's operating income of $57 million and 12.5% margin.

Turning to electronic systems on slide 10, first-quarter revenue was $374 million, compared to $378 million in the prior year. Higher revenue from the F-35 production ramp was offset by lower electronic warfare revenue. This was primarily due to a higher mix of programs in the development phase versus production phases. Segment operating performance improved compared to prior-year pro forma. Operating income in the first quarter was $69 million, and operating margin was 18.4% compared to last year's operating income of $56 million and 14.8% margin.

Turning to critical networks on slide 11, first-quarter revenue was $566 million, compared to prior-year pro forma revenue of $644 million. As anticipated, revenue declined due to continuing services weakness in the government and energy markets. Segment operating income was $63 million, compared to prior-year pro forma of $72 million, but operating margin held relatively in line with the prior year on lower revenue.

Moving to slides 12 and 13. FY16 guidance remains unchanged for GAAP EPS, in a range of $5.25 to $5.45, and non-GAAP in a range of $5.60 to $5.80. FY16 non-GAAP EPS excludes expected integration costs in the range of $60 million to $65 million, and a $10 million charge related to inventory step-up. Non-GAAP EPS includes the intangible amortization from the Exelis acquisition of $133 million, or about $0.70 per share.

Revenue guidance is unchanged, in the range of $7.67 billion to $7.83 billion, down 3% to 5% on an organic basis compared to FY15 pro forma of $8.09 billion. And while segments have changed, our expectations for revenue drivers within the segments are consistent with the previous color we provided. In communication systems, we expect organic revenue to be down 2% to 3%. Public safety is expected to be down low to mid single digits.

Tactical communications on the new basis, including the ground and airborne radios of both companies, as well as night vision products, is expected to be down low single digits. This aligns with our previous expectations for Harris legacy tactical, DoD flat to up low single digits, and international flat to down low single digits. Operating margin for the segment is expected to be in a range of 29.5% to 30.5%, which assumes legacy Harris tactical margin in line with FY15, and consistent with previous expectations.

In space and intelligence systems, revenue is expected to be flat to up 2%, with growth in intelligence areas, partially offset by lower revenue from space payload programs. Segment operating margin is expected to be in a range of 15.5% to 16.5%. Electronic systems revenue is expected to be down 1% to up 1%, driven by the F-35 production ramp. Segment operating margin is expected to be in a range of 18% to 19%.

In critical networks, revenue is expected to be down 10% to 12%, due to continued services weaknesses, with an operating margin in a range of 11% to 12%, as we keep the focus on lowering costs. We continue to expect free cash flow for year greater than 100% of GAAP net income, adjusted to add back the $88 million after-tax impact of the amortization of acquisition intangibles.

Let me 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*

Thanks, Mick. So I won't repeat the budget details that all of you already know, but suffice it to say that a two-year deal would be a positive for Harris as well as the industry, signaling a long-awaited budget bottom and the rise in government spending.

Overall, we had a good start to the fiscal year. We're capturing integration savings which will continue to ramp through the year and benefit earnings. And while we continue to expect a soft top line environment to persist in the second quarter, partially due to Exelis's relatively strong prior year-end December quarter results, we are encouraged by the orders rebound in the first quarter.

Momentum for US tactical modernization is building, and the recent SOCOM award, on top of the early awards of the Rifleman Radio and the Mid-Tier radio are testament to the strength of Harris's commercial model and the positive return on our sustained investments in R&D through the market downturn.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Pete Skibitski, Drexel Hamilton.

Pete Skibitski - *Drexel Hamilton - Analyst*

On the book to bill of 1.24, I think it's one of your strongest quarters ever. Is the SOCOM STC, is that win in there, any orders, or because of the protest, is it not in there?

Bill Brown - *Harris Corporation - Chairman and CEO*

It is not because of the protest either, but SOCOM is not in there, but it would be an ID/IQ, so we would not be booking that as a funded order. Basically, the strength principally comes from very strong results in our tactical radio business, as I mentioned, up 30%, and pretty broad base across both DoD as well as an international side. And we saw very good orders growth in electronic warfare and space superiority, and our proprietary business and a couple of other areas, and that is really what drives that big strong orders growth in the quarter.

Pete Skibitski - *Drexel Hamilton - Analyst*

Okay. That is great. And then, Bill can you give us like you have in the past, the size of international radio pipeline?

Bill Brown - *Harris Corporation - Chairman and CEO*

Yes, the international pipeline means pretty robust, and we're very pleased with that. It's about $2.4 billion, the shape moves around a little bit, but not a lot. It's been fluctuating between $2.4 billion in $2.5 billion over the last number of quarters. But given our very strong orders growth in Q4, remember, orders are up 73%, book to bill was 1.1%, which it was very, very pleasing to end Q4, we had another strong orders growth in Q1, so the pipeline remains pretty robust at $2.4 billion, and again, it's like the comments I made before in terms of its shape, it's primarily, a little more than half Middle East, North Africa, central Asia, a couple of other areas that we saw very, very good growth. And in fact, the orders growth in the quarter, as I mentioned in my comments, were pretty broad based across the geographies outside the US.

Pete Skibitski - *Drexel Hamilton - Analyst*

Thanks, I'll get back in queue.

Operator

Seth Seifman, JPMorgan.

Seth Seifman - *JPMorgan - Analyst*

I just wanted to go back to one of the last comments that you made about the second quarter, and I know you might want to shy away from giving quarterly guidance. But just in terms of the guidance for the year, 22% roughly -- a little over 20% of the revenue in Q1, it sounds like it's a little bit more back-end weighted, whereas last year, about half the sales for the combined company where in the first half. Could you talk a little bit about your level of visibility and level of confidence in the second half sales pickup?

Bill Brown - *Harris Corporation - Chairman and CEO*

You're right in those comments, we do think it's more back half than front half loaded. That's the way we built our plan for the year, so it's not surprising we had, we're a little light in Q1, down 6% organically. We know that bringing Exelis into our business, we showed our numbers on a pro forma basis, they had a fiscal year last year which ended in December, so their fourth quarter was now our second quarter. They had a pretty strong run at that quarter, as a lot of companies do in the last quarter of their fiscal year. So that does give us some year-over-year headwind.

Keep in mind, we're still under a continuing resolution. There's no appropriations budgets yet. That still does drive some stickiness in the funding outlays for what is now our second quarter. We do expect, given the budget deal and more favorable comparisons, to see a recovery in the back half of our fiscal year.

Seth Seifman - *JPMorgan - Analyst*

Great. Thanks. And as a follow-up, wonder if you could talk about trends in the critical networks business. That's one business where it seems like the sales that you booked in the first quarter are on par with a run rate that you are looking for through the year, and are things stabilizing there? I know there's two markets there, where there's a couple of challenges in the government services and in energy, and what's the latest there?

Bill Brown - *Harris Corporation - Chairman and CEO*

It is a business that came out of the gates a little soft, and we're guiding down 10% to 12% for the full year. Q1 was down 12%. We're very pleased that we're protecting the margins. I think we're doing a good job in taking cost out in spite of the pretty weak revenue environment, but Seth, you hit the nail on the head. It is two soft markets.

One is government IT. That we see down in the midteens for the year. Not different than what we talked about last time, as both our IT services businesses as well as the Exelis IT business. Q1 was down a bit worse than that in government IT services.

But we do expect that the revenue will be roughly flat sequentially over the balance of the year. The book to bill in Q1 was about -- was over 1, and we expect it to be about 1 for the year, so I think that feels pretty good. Keep in mind in IT services, we have a couple of unique dimensions happening here. One, Exelis lost the space long-range system contract prior to the acquisition, happened just over a year ago, and that's rolling through the numbers, that's about $85 million.

And there's a couple of other programs that we are transitioning out of at Harris, specifically the NMCI contract and a pretty large VA program that ended last year. There's a couple of different things, dynamics that are happening, that are relatively unique in that government IT market for us. We are refocusing on the intelligence community. We think that there's an opportunity to differentiate ourselves in that space. Some of those awards are moving a little bit to the right, but I think that's going to start to see some stability through the balance of the year, as at least in terms of sequential growth.

The other one that has an impact in the quarter is, as you suggested, is in the CapRock energy business. We expected that to be weak in the year. It's going to be down on a full-year basis, mid-teens in Q1. It was a little bit worse than that.

We know that the oil is still relatively weak. We saw the results from a lot of the oil service companies and majors over the last quarter. Rig count remains pretty weak. It's down about 40% year-over-year. In some of the oil majors and service companies are announcing more restructurings and CapEx cuts.

So we do see continued pressure in that business. We're watching it very, very carefully. We think we've calibrated our year, but again the market is pretty volatile at this point, and we keep watching it. The piece in that, in critical networks that is relatively stable we feel good about, and that's on the FAA side.

We've got a good portfolio of businesses with the FAA. It's pretty broad based, and we feel very good about our position in the funding pattern for the FAA programs within critical networks. So Seth, when you put all of these pieces together, a long-winded way of saying it, that is where the critical networks is down about 10% to 12% in the year.

Seth Seifman - *JPMorgan - Analyst*

Great. Thank you very much.

Operator

Steven Cahall, Royal Bank of Canada.

Steven Cahall - *RBC Capital Markets - Analyst*

Maybe just a first one on margins. If I'm reading the slides correctly, and we're looking at the pro forma margins at the segments, you had a big step ups in three out of the four segments. Was there anything to read across from that, in terms of how they phase through the year, or is this just a seasonally strong quarter for margins?

Bill Brown - *Harris Corporation - Chairman and CEO*

We don't typically see seasonal strength in Q1. It moves, based on things going on in the businesses quarter to quarter. But I would say we do expect to see synergy savings ramping over the balance of the year. I mentioned in my comments we had $11 million in Q1. Sheldon talked about $70 million to $75 million in the full year, so of course, that is -- that's going to happen, the bulk of that's yet to come and not in our numbers.

So you will see some strength coming in the numbers simply because of integration savings, which are booked within the segments. The other side is we are pushing very hard on our legacy operational Harris Business Excellence program, and we do see opportunities to continue to protect margins in each of the segments because of that. Three of the segments, very strong margin expansion. One that we feel pretty good about holding margins, in spite of a pretty significant revenue downturn. So I think from Harris, I think good control on our cost structure so far.

Steven Cahall - *RBC Capital Markets - Analyst*

Great. Thank you. That second question maybe on a couple of the big programs. I was wondering if you could give us maybe what your view is on the manpack contract as to how you see the field laying out? Do you think, like Rifleman, it will be yourselves versus a competitive field of an additional one, or could it perhaps be more than one? And then similarly with what you been able to do on the domestic programs, do you see a big opportunity to change the scope and direction of the UK's Bowman replacement, and is that a major opportunity going forward? You can get them to think outside of their current provider?

Bill Brown - *Harris Corporation - Chairman and CEO*

First on, on the first one, on the manpack, bids are in, so it's still in the source selection process. So I really don't have insights into who else has been coming to the table, more than what has been rumored in the press. As I mentioned in prior comments, the Army does expect tuition award, could be as early as December. We're thinking more it's early next calendar year, depends upon who comes to the table.

They are expecting to issue up to three ID/IQ awardees, and that's what we see at this point. We know that it's going to be a very large $12 billion plus ceiling value ID/IQ, and I think we're very, very well positioned for that. So I feel very good about where we happen to be on the manpack, and not much more to say at this point, given the status of that opportunity. Relative to Bowman, or more, I think that can be a pretty interesting opportunity for us. Exelis is an important player there, as has Harris has been.

We together more of a formidable player in the UK. We have been working with other partners in the UK. That's going to be has been shaking itself out over the next several years, next several quarters. So I don't really want to say too much more about how we might position ourselves for success in the UK. But Steven, Dana Mehnert, who now is head of our global business development group, and who built tactical radios to what we do today, is leading our global BD organization, and I can assure you, he is focused on the UK.

Steven Cahall - *RBC Capital Markets - Analyst*

Great. I appreciate that color.

Operator

Gautam Khanna, Cowen and Company.

Gautam Khanna - *Cowen and Company - Analyst*

Bill, can you quantify the run rate eventually on programs like MNVR, the Rifleman program and manpack? As far as you can tell, there are eventually two awardees on that. What is the run rate? I know what the budgeted dollars are, but what do you actually anticipate to mature their run rate today?

Bill Brown - *Harris Corporation - Chairman and CEO*

It is really hard to put a number on it outside of what is in a PBR guide, to be honest with you. I would be speculating, and boy, I hate to do that on these kinds of calls, so I won't. As we said before, MNVR last year was $8 million to $10 million, $12 million in revenue. This year, it will be more twice that, $20 million to $25 million. We see that could grow to $40 million to $45 million.

Again, it depends upon what the Army wants to do and how do want to field the radio in their BCT structure, and all sorts of other dynamics that come into play. We do know that between the Rifleman and the manpack, that we've been told, could be a procurement up to about $0.5 billion a year, if you look at the PBR, that is what it says. We don't have any more insights relative to the total market opportunity for us. What it our job is to do is to put forth our most aggressive approach of fantastic technologically advanced and innovative product, and win 100% share of that business, whatever it happens to be, and that's what we're focused on.

Gautam Khanna - *Cowen and Company - Analyst*

Could you comment on what the Rifleman is running at in the current fiscal year?

Bill Brown - *Harris Corporation - Chairman and CEO*

Rifleman won't be any revenue in this year or next. It will start to ramp at the end of FY17, is when the Rifleman will start to ramp. It is probably the second half of our FY17, and it will become a little bit more meaningful in FY18.

Gautam Khanna - *Cowen and Company - Analyst*

In terms of the, you mentioned the ERISA minimum requirement of $173 million to the pension. Can you comment on any initiatives you've undertaken to reduce the ongoing cash burden of the pension?

Bill Brown - *Harris Corporation - Chairman and CEO*

Thanks, Gautam. I'll toss it to Mick, and let Mick comment on that.

Mick Lopez - *Harris Corporation - SVP and CFO*

Thank you very much. I think as we've said, there have been multiple actions taken in the past from 2011 freezing the new hires and lump sums liabilities given out, and we actually froze the benefits in the end of 2016. So moving forward, we see that we'll be trying to address the asset side and the liability side.

On the liabilities, we're considering some cash balance for the actives. Perhaps some lump sum for some of the term vested employees to take advantage of the IRS rulings. And insofar as moving forward to matching our assets to the obligations' longevity. So we'll be risked through the flying glide paths, and with specific trigger points.

Gautam Khanna - *Cowen and Company - Analyst*

Is it fair to assume that in your $1 billion free cash flow, you are targeting four years out, so you're not expecting some meaningful decline in the ongoing cash contribution of $170 million or so?

Bill Brown - *Harris Corporation - Chairman and CEO*

We see a modest reduction in cash contributions going to next fiscal year. FY17 in the $170 million range. We do see, in the FY19, FY20 period down, could be quite less than that. So in FY19. So when you think about three years out, FY18 hitting $1 billion, hitting that $1 billion of free cash flow target three years out does not include really any reductions in pension contributions, it really happens to be on that horizon.

Gautam Khanna - *Cowen and Company - Analyst*

Got it. One last one, on the foreign pipeline, the $2.4 billion, are you anticipating any significant single contract awards from that, or is it a fairly lumpy thing, or is it diverse across many smaller opportunities? If you could just give us some sense if we should be expecting a huge Australian win or a huge Saudi win. What should we be looking for?

Bill Brown - *Harris Corporation - Chairman and CEO*

There are certain markets, and you hit on a couple, that are quite large in a longer term pipeline, and we do see our position in Australia strong. There's a procurement on the horizon that goes out beyond 18 months that is quite substantial, and we're in the mix of that, but it's not in that 12 to 18 month pipeline. It is really pretty broad based. It is across a lot of different markets through the Middle East, through North Africa, into central Asia. It was very, very good to see FMS funding through OCO accounts continuing to bolster what's happening in Iraq through the train and equip funds, through ERI, which flowed through into some opportunities in the Baltics, we saw some good opportunities surface in Latin America this past quarter, and are still in our pipeline, so Gautam, it is pretty broad based. There's not any big substantial orders that are in our 12 to 18 month horizon that I would want to single out. Beyond that, there is some big opportunities in markets like in Saudi, as well Australia, but nothing that is gigantic in the next 18 months.

Gautam Khanna - *Cowen and Company - Analyst*

Thanks. I'll get back in the queue.

Operator

Chris Quilty, Raymond James.

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

Thanks, wanted to touch on two legacy Exelis programs. You mentioned within the space and intel, a downturn in some commercial space payloads. I assume that's the old Kodak camera manufacturing business, and there have been lots of changes in terms of the space imaging business. Can you give us a sense of what you think the prospects for that business are on a go-forward basis?

Bill Brown - *Harris Corporation - Chairman and CEO*

Thanks for the question, Chris, and I'll take the first and maybe turn to Sheldon on the second, he can elaborate a little bit. The downturn on the space payloads really is more legacy Harris than legacy Exelis. You remember a couple of years ago, we booked an opportunity with Aereon for putting hosted payload on an Iridium NEXT Constellation. That work has been through the pipeline.

We are delivering vehicles. We're pretty far down the path of recognizing revenue and opportunity, and that is starting to move back off. That is more on the legacy Harris than legacy Exelis perspective. Let me turn to Sheldon maybe to give a couple of comments on outlook for space imaging.

Sheldon Fox - *Harris Corporation - SVP and Integration Lead*

Chris, the outlook up in Rochester for Exelis's legacy imaging business is actually very strong. They've had an upturn in the number of new orders and new programs they have. They're hiring up there in Rochester. And they've developed some exciting technologies that we believe have application both in their traditional market spaces and in this new emerging commercial market imaging space, so we're very bullish on their imaging business in Rochester.

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

Got you. The other legacy Exelis question, the counter IED programs, it seems like you had a nice order this quarter. What is the longer term prospect in that area?

Bill Brown - *Harris Corporation - Chairman and CEO*

Well, certainly this year, it is going to be pretty solid. And it's going to be a driver of growth in 2016 over 2015. It remains to be seen what happens beyond 2016, but right now, we feel pretty good about the opportunity we saw come through the Department of State, and that's going to drive growth this year, Chris.

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

Great. Thank you.

Operator

Noah Poponak, Goldman Sachs.

Taye Scolia - *Goldman Sachs - Analyst*

It's actually [Taye Scolia] from Noah's team. We were curious, actually on how you see the new budget deal helping short cycle defense, if you could give us a little bit of color on that?

Bill Brown - *Harris Corporation - Chairman and CEO*

Well look, the two-year deal is pretty encouraging to us. It is encouraging to the rest of the industry. It's going to eliminate some of the overhang of uncertainty, and all of that is good news.

I think you know the budget like we do. DoD is up 5% in FY16, maybe another 2% in FY17. That's pretty good. We were very pleased with the size of the OCO accounts because some of the funding that we used for international comes out of OCO accounts like [ITF] and ERI and a couple of counter terrorism partnerships on other things that will help us definitely in 2016 and going forward into 2017. Look, it is a deal. There is no appropriations bills yet.

That needs to flow itself out, and that will happen between now and hopefully December 11. But judging by what was in the NDAA that was unfortunately vetoed by the president, but is going to flow back through, I think a lot of the Harris programs seem to be well supported both in the technical, normal tactical line, as well as in other things that affect Harris Corporation. I do think that to the budget deal and the certainty and the level of funding is going to be good news for Harris, both short cycle and medium cycle opportunity, as all the rest of the industry, so net-net, I think that is just good news.

Taye Scolia - *Goldman Sachs - Analyst*

Great. That is helpful. And just if I may, another question. If you could break down the $2.2 billion in orders that you have other new segments, it would be helpful.

Bill Brown - *Harris Corporation - Chairman and CEO*

I don't think we're going to do that today. I'm sorry. I gave the comments on where we saw some strength, and I gave you some comments on where we saw a little bit of weakness. I think we'll stay at that relatively high level of color at this point.

Taye Scolia - *Goldman Sachs - Analyst*

Okay. Thank you very much.

Operator

Pete Skibitski, Drexel Hamilton.

Pete Skibitski - *Drexel Hamilton - Analyst*

A couple of follow-ups. Can you maybe share with us your expectation for cash taxes for the full year?

Bill Brown - *Harris Corporation - Chairman and CEO*

I will turn to Mick on cash taxes.

Mick Lopez - *Harris Corporation - SVP and CFO*

Our tax rate is, as we said it's going to be up 34% for the year. First quarter was slightly lower. The timing of the cash taxes depends on quarter to quarter, but I think for the year, it will be slightly lower than the 34%, we had some credits from last year.

Pete Skibitski - *Drexel Hamilton - Analyst*

Okay. On operating working capital, you are normally really good on a full-year basis on operating working capital. Looks like in the first quarter, there will be some timing items. Do you expect to make that up as you go through the year, or are you just going to be more of a use of cash for working capital?

Bill Brown - *Harris Corporation - Chairman and CEO*

We do expect to make up for what we knew was going to be some snap back that happened in Q1. You'll recall in our Q4 release, we had some quote-unquote overdrive on AP, on payables, and we said about half that was going to snap into Q1. It did. But we're focused on improving working capital over the course of this year. That's an important driver for our free cash flow guidance that we've given to investors.

Pete Skibitski - *Drexel Hamilton - Analyst*

Okay. Great. I guess I can sneak in a last one, I wanted to talk about the legacy Exelis product lines. If I do the math, it looks like Exelis night vision radios is down on the order of 20% or so. Should we annualize that? Is that business dropping off that quickly? I was expecting that it already troughed kind of the warrant draw down.

Bill Brown - *Harris Corporation - Chairman and CEO*

I won't give color so deep into the businesses at that level, but I would say that on the night vision side, five years ago, it was quite big, based on what was happening in the wars. It's come down. It is starting to bottom out and flatten out, and we are doing I think an outstanding job in our Roanoke facility, to improve quality and meet delivery schedules with the Army. We gained credibility, I think we're doing a very good job, and I do see stability in that business.

As Sheldon mentioned in his remarks on the Exelis side, is a very large installed basis, SINCGARS radios in the US and outside US. And in fact, there's lots of countries that have standardized on SINCGARS and they will continue to buy that. We do expect to see growth opportunities in SINCGARS, and hopefully we can leverage more of the existing Harris channels to open up some new opportunities that hadn't been there before.

So I wouldn't give any more color than that. There has been some downturns in that night vision comp systems business. But we feel pretty good about the prospects going forward.

Pete Skibitski - *Drexel Hamilton - Analyst*

Great. Thank you.

Operator

Gautam Khanna, Cowen and Company.

Gautam Khanna - *Cowen and Company - Analyst*

Thanks again. You mentioned in the foreign pipeline, Australia and the Middle East are big opportunities, and I just wondered, those commodity linked economies, the US dollar obviously has strengthened. I just wondered, are you seeing any incremental price pressure or delays in terms of procurement prior to the actual contract signing.

Bill Brown - *Harris Corporation - Chairman and CEO*

Yes. We do see price pressure all the time in our international business, because it's very competitive and that has been the case, and it's one we continue to deal with through a lot of cost reductions and bringing technology. We sell our product in dollars, and that does cause some headwind with non-US providers. Some competitive pressure, but we respond aggressively to that.

On the other commodity side, which is on the oil side, we have seen some stretch-outs in a couple of markets. We talked about this last time, that remains the case today in Iraq and in Saudi, where we have seen some stretch out in some of the opportunities. It is factored in our pipeline, and is factored in our guidance for the year. We do know that in Saudi, they have prioritized investments for their military to combat the border strife with Yemen, but again, those things have already factored into our guidance.

Gautam Khanna - *Cowen and Company - Analyst*

Okay. And one other thing. If I recall the Exelis pension, I think the majority of it related to non-Exelis employees, and wondered if, could you update us on that, and how much of that pension is actually recoverable via CAS reimbursement?

Mick Lopez - *Harris Corporation - SVP and CFO*

Yes. There's about 47,000 participants in that pension, and insofar as the number of employees, it's almost 50-50. But the majority because of the activeness of the retirees is mostly defense-related. And I think we mentioned that last year the CAS recoverability for Exelis was about $129 million. We expect that to be a little bit higher in FY16.

Gautam Khanna - *Cowen and Company - Analyst*

And how does that relate to the FAS? Can you just remind us?

Mick Lopez - *Harris Corporation - SVP and CFO*

The FAS is a positive income of $25 million.

Gautam Khanna - *Cowen and Company - Analyst*

Okay. And just in terms of as we look forward at FY16 and FY17 could you just give us a sense for what the downturn is going to be between FAS and CAS?

Mick Lopez - *Harris Corporation - SVP and CFO*

They're going to be fairly constant, is you well know, a lot of it depends on your expected return on assets and your discount rates. Looking out a year is, I would say, going to be very, very constant, not large changes. We've actually done some sensitivity analysis for what happens if the market gyrates up or down, and it's not that significant change. It does materially impact you in the farther out years, and that's way we think to give our guidance to current year.

Gautam Khanna - *Cowen and Company - Analyst*

Understood. Thanks a lot.

Operator

Seth Seifman, JPMorgan.

Seth Seifman - *JPMorgan - Analyst*

Thanks very much. Just one quick follow-up. The booking strength in the first-quarter was very impressive, and I know it's not something we can expect every quarter, but how would you think about the possibility to end the year with book to bill greater than 1 across the Company?

Bill Brown - *Harris Corporation - Chairman and CEO*

It's a good question, Seth, and that's certainly what we aspire to do every year, is to build our backlog. So that certainly would be our goal for the year as we see where we are at today. But you are right, we had a good start to the year. 1.24 book to bill is pretty good, the backlog coming up is pretty good. I was very pleased, Seth, as you can imagine with the growth in the tactical business, and increasing in tactical backlog, and I think if that holds through the year, I think we'll be in great shape.

Seth Seifman - *JPMorgan - Analyst*

Excellent. Thank you very much.

Pamela Padgett - *Harris Corporation - VP of IR*

Operator, I think we have one more question.

Operator

Steven Cahall, Royal Bank of Canada.

Steven Cahall - *RBC Capital Markets - Analyst*

Thank you. Just a follow-up on the portfolio. I think in the last quarter you talked about taking a passionate approach and possibly seeing some opportunities for portfolio shaping. So I was wondering if you could just update us with that, and are there any specific businesses where you think you might be subscale, be that some of the legacy Exelis businesses like the structures or PSPC or critical networks, and should we expect to see a discontinued operations line at some point in the relative near future?

Bill Brown - *Harris Corporation - Chairman and CEO*

Well Stephen we continue to take a very dispassionate view, so thanks for remembering that. We have said that as we're now an $8 billion company with a broader set of businesses, we have an opportunity for some portfolio shaping. We are really taking a hard look at that. We're looking at across all of the different businesses.

You threw a couple of names out there which we're obviously not going to comment on any specific plans today. We're not ready to do that, but it's something we continue to look up. And as we have things that to announce or discuss with investors, we'll be certain to do that.

Pamela Padgett - *Harris Corporation - VP of IR*

Okay. With that last question, I think we'll close the call for the day. Thank you everyone for participating.

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.
