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# EDITED TRANSCRIPT

## HRS - Q4 2016 Harris Corp Earnings Call

EVENT DATE/TIME: AUGUST 02, 2016 / 12:30PM GMT

**OVERVIEW:**

HRS reported 4Q16 EPS of $1.45. Expects FY17 revenue to be $7.1-7.3b and GAAP EPS to be $5.53-5.73.





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## CORPORATE PARTICIPANTS

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

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

**Rahul Ghai** *Harris Corporation - SVP & CFO*

## CONFERENCE CALL PARTICIPANTS

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

**Howard Rubel** *Jefferies & Company - Analyst*

**Seth Seifman** *JPMorgan - Analyst*

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

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

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

## PRESENTATION

**Operator**

Welcome to the Harris Corporation's fourth-quarter 2016 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, Pamela Padgett, Vice President, Investor Relations. Please go ahead.

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

Hi. Good morning, everyone. Welcome to our fourth-quarter 2016 earnings call. I'm Pamela Padgett. On the call today is Bill Brown, Chairman and CEO; and Rahul Ghai, Senior Vice President and Chief Financial Officer.

First, 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 a related discussion please see the press release, the presentation, and Harris SEC filings.

In addition, a reconciliation of non-GAAP financial measures discussed today to comparable GAAP measures is included in the quarterly materials on the Investor Relations section of our website, which is www.harris.com, where a replay of this call is also available. With that, Bill, I'll turn it over to you.

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

Okay, well, thank you, Pam. Good morning everybody. Overall, FY16 was a solid year, and I am pleased with our performance. Earnings per share increased 11% to $5.70 on organic revenue down 7%. Operating margins were up 60 basis points to 16.2% and free cash flow was strong at $772 million. Book-to-bill was greater than 1.

We executed well against the key priorities we set out at the beginning of the year. First was to successfully integrate Exelis, a company which added scale, a broader portfolio of technologies, new market opportunities and improved operating resilience. And we're moving faster and achieving greater savings than initially expected. We exited FY16, year one of integration, at a net savings run rate of $120 million, the top end of what we originally committed to by year three. And we're tracking well towards achieving $140 million to $150 million net as we exit FY17.

The second priority was to continue to reshape our portfolio and in April, we sold the Aerostructures business we acquired with Exelis at an attractive multiple, using the proceeds to pay down debt.

The third priority was to maximize free cash flow and we exceeded our guidance of $750 million through tight management of capital spending and a four-day improvement in working capital, absorbing over $100 million in cash restructuring and integration costs and $174 million in cash and pension contributions.

And finally, our fourth priority was the deleverage and during the year, we retired $650 million in debt, about one-third of our three-year debt reduction goal, allowing us to rebalance our capital deployment priorities as we reinitiate share repurchases in FY17 with a placeholder of $150 million.

And we executed these priorities while also continuing to drive operational excellence deep into the Company to lower costs and improve program execution, reinvesting some of the savings in R&D to drive future growth. Company-funded R&D was again this year a little more than 4% of revenue, a spending rate higher than our peers, and which has led to a number of important strategic wins.

So let me provide a few highlights of the quarter before Rahul discusses our detailed segment financial performance. Fourth quarter earnings per share was $1.45, up 10%, with results benefiting from the acquisition, a lower tax rate and improved operating performance. Operating profit was up 6% and margin improved by 190 basis points on organic revenue down 6%. Improved performance was driven by the capture of synergy savings, lower cost and solid execution within Space & Intelligence, Electronic Systems, and Critical Networks all contributing to higher income and higher margin.

Space and Intel had another terrific quarter, with revenue up 10% and operating margin up 510 basis points, following an equally impressive Q3, with continued strength in the classified area, including space superiority and protection. We're successfully leveraging our broader technology portfolio and in the quarter, we were awarded a $104 million contract as prime in a new classified mission area that could potentially develop into another key franchise for Harris.

In the commercial space market, we are seeing the beginning of a recapitalization and fleet expansion cycle. Following an award in Q3 for a new 18-meter space reflector, we received in the fourth quarter a contract from Airbus for a 12-meter folded rib reflector for the European Space Agency's Biomass satellite. Our opportunity pipeline in this area remains robust heading into FY17.

Electronic Systems also delivered excellent results, with revenue up 4% driven by higher electronic warfare and counter-IED sales and 910 basis points of margin expansion. Electronic warfare was up in both Q3 and Q4, coming off a weak first half, and we continue to win modernizations on legacy platforms, with orders for the year doubling over prior year.

And significantly following the close of the quarter, ES received a two-year $189 million contract from a country in the Middle East to provide the land forces with an integrated battle management system, showcasing our competitive strength as a prime contractor providing an integrated solution. The contract is for one brigade, but there are opportunities to add three more land brigades, sustainment, radios and an operation center to incorporate air, Navy and ground force communications. This contract also positions us well for similar projects in other countries in the region.

And while critical networks was down 6%, it was better than expected and strong cost controls and program execution, along with savings from prior quarter restructuring actions at CapRock, drove 310 basis points of margin expansion in the segment.

On the other end of the spectrum, Communication Systems was weaker than expected, with revenue down 24% and margins 250 basis points lower than prior year. Tactical communications declined 29%, with legacy Harris down 40%, with book-to-bill of 0.92.

In the International market, funding remains relatively solid, but our $1.77 billion follow-on contract that supports foreign military sales took longer to finalize than expected and coupled with an overburdened administrative approval process for task orders, caused several opportunities to stretch out beyond the end of the year. In July, we booked all the revenue that slipped from Q4.

The US tactical market was also soft in the quarter as we're starting to see more cautious customer buying behavior in advance of a likely CR this fall. So while I'm disappointed by the fall-off in Communication Systems, I'm really proud of how the team responded to meet the earnings and cash flow guidance presented in our Q3 call, pointing to the operating resilience of the new post-acquisition Harris.

Today, we're initiating guidance for FY17, reflecting continued progress and solid execution of our strategy. We expect earnings per share of $5.70 to $5.90, flat to up 4% on organic revenue down 1% to 4%, with operating margin continuing to increase due to synergies, lower costs and pension tailwind and with another year of strong free cash flow.

We've set FY17 guidance expectations for tactical in line with a slower environment we're currently experiencing and we believe we are being appropriately conservative in our estimates. So before turning the call over to Rahul to provide some detailed segment results and guidance, I'd like to comment on the joint press release with JANA partners issued earlier today.

As a result of constructive engagement with JANA, we reached an agreement to appoint two mutually agreed independent directors to our Board. One will be announced in early September and both will be nominated in our proxy for the October Annual Meeting. We have an ongoing dialogue with all of our shareholders and we welcome their input.

We have a long history of strong corporate governance and we are far more committed to maximizing long-term value for all of our shareholders. We look forward to the contributions that these two new directors will bring to the Board. So with that, let me turn it over to Rahul.

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**Rahul Ghai** - *Harris Corporation - SVP & CFO*

Thank you, Bill, and good morning, everyone. Just to remind you, discussions today are on a non-GAAP basis. So turning now to segment detail on Slide 5 and comparisons to prior year pro forma results. Organic revenue comparisons exclude Aerostructures and just like prior quarters are as if Exelis and Harris were combined for all of FY15.

Communication Systems segment revenue was $436 million and down 24% compared to prior year. Tactical Communications was down 29% and Public Safety down 10%. Higher tactical revenue in Europe and central Asia was more than offset by lower tactical revenue in Northern Africa due to the expected completion of a large modernization tranche and by lower revenue in the Middle East. And even though the Middle East market remains relatively soft, revenue from the region was up sequentially.

Operating income in the fourth quarter was $120 million and operating margin was still strong at 27.5% even on much lower revenue. We ended the year with legacy Tactical backlog of $402 million and slightly lower than the third quarter backlog of $419 million as a result of orders that pushed out from the $1.77 billion IDIQ from fourth quarter that Bill just referenced. On Slide 11, we have again included historical information for legacy tactical orders, revenue and backlog.

Turning to Space & Intelligence Systems on Slide 6. Revenue was $529 million, up 10% compared to prior year, driven by higher revenue from a number of new classified programs, including the [aerospace] superiority and protection. Operating income in the fourth quarter was $83 million and operating margin was strong at 15.7% compared with last year's operating margin of 10.6%. In addition to the classified orders that Bill has already addressed, Harris was awarded a three-year $38 million contract for Advanced Baseline Imager spare modules for weather monitoring aboard NOAA's GOES-R satellites. This win is an excellent example of the complementary nature of combining Exelis' sensor capability for satellites with Harris' [cloud] processing capability.

Turning to Electronic Systems on slide 7. Revenue was $381 million and up 4% on an organic basis compared to prior year, with higher revenue in electronic warfare and counter-IED systems. Operating income in the fourth quarter was $73 million and operating margin was solid at 19.2% compared with last year's operating margin of 10.1%.

Turning to Critical Networks on Slide 8. Revenue was $575 million and down 6% compared to prior year. Higher revenue from FAA's NexGen Modernization programs was more than offset by lower revenue in IT services and from the wind-down of two major programs mentioned in previous earnings calls, and lower revenue in CapRock's energy business. Operating income in the fourth quarter was $81 million and operating margin was 14.1%. Margin improvement was in large part driven by previous CapRock cost reduction actions that resulted in CapRock's energy business returning to profitability in the fourth quarter despite significantly lower revenue than the third quarter.

So moving to Slides 9 and 10. Today we are initiating fiscal GAAP EPS guidance in a range of $5.53 to $5.73, and non-GAAP EPS in a range of $5.70 to $5.90. Non-GAAP EPS excludes about $30 million to $35 million of integration costs. To remind you, non-GAAP guidance still includes approximately $132 million, or about $0.70 per share, of Exelis acquisition intangible amortization.

Revenue is expected to be in a range of $7.1 billion to $7.3 billion, down 1% to 4% on an organic basis excluding Aerostructures. EPS guidance reflects a change in FAS accounting methodology. Today, we have used a -- historically, we have used a single discount rate for calculating the interest and service costs associated with pension obligations. Beginning in FY17, we will measure the FAS pension cost in a given year using the spot rate approach. We adopted this approach as we believe it provides a more precise measurement of our pension service and interest cost, since it matches each year's individual spot rate to the projected cash flows in that year. We also reduced our expected pension asset rate of return assumption by 25 basis points to 7.75% for 2017.

EPS guidance also includes $150 million in share repurchases planned during the year. Other EPS guidance details are outlined on Slide 9, including an expected tax rate of 31%, in line with FY16 results. We expect free cash flow to be approximately $800 million in FY17. We ended FY16 with 49 days of working capital, a reduction of four days from the beginning of the year. Our FY17 guidance reflects continued improvement in working capital performance and CapEx spend of approximately $175 million.

Turning now to segment guidance. In Communication Systems, revenue is expected to be down 7% to 9%, with significant decline in Tactical Communications and Public Safety trending higher. Within Tactical Communications, Harris legacy DoD is expected to be flat to up and legacy International down in mid teens. In legacy DoD, we expect fourth quarter's cautious buying behavior to continue. However, we also expect MUOS and initial army modernization to contribute to revenue in low tens of millions each. In legacy International, since the third quarter earnings calls, our views have not changed significantly on where we expect areas of opportunity and challenges in FY17. Overall, we expect revenue to be once again underpinned by FMS funding support for opportunities in Eastern Europe, Middle East/Africa and Central Asia. Segment operating margin is expected to be in a range of 29.5 % to 30.5%, reflecting the impact of lower revenue, offset by synergies from Exelis acquisition.

In Space & Intelligence Systems, revenue is expected to be up 1% to 3%, with continuing strength in classified and uptick in commercial space. Segment operating margin is expected to be in a range of 16% to 17%. In Electronic Systems, revenue is expected to be up 1% to 3% on an organic basis. Revenue will be higher in electronic warfare, driven by the growth in backlog in 2016, and in C4i, given the recent significant $189 million win that Bill just referenced. Segment operating margin is expected to improve to a range of 20% to 21%.

In Critical Networks, revenue is expected to be down 3% to 6%, with mission networks revenue trending higher due to our solid FAA franchise and International Air Traffic Management opportunities. This is being a more than offset by continued weakness in CapRock energy and still tough compares in IT services. For IT services, we expect revenue to stabilize at approximately $225 million to $250 million a quarter. Segment operating margin is expected to be in a range of 12% to 13%. So now let me turn it back to Bill for a few closing comments.

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

Okay, well, thank you, Rahul. Overall, FY16 was a solid year. Excellent progress in a multi-year strategy to successfully integrate Exelis and realize the full synergies and accretion. We will continue to drive operational excellence program to not only lower costs but also to streamline processes, improve program execution and increase customer satisfaction. And we will continue to reinvest in R&D to grow our core franchises and address near adjacencies where technology and innovation are differentiators.

An Important part of our strategy to drive shareholder value is optimizing our business portfolio by focusing on investments in which technology provides differentiation. We dispassionately, objectively and aggressively assess which businesses strategically fit and are a better value to Harris, as well which businesses may be a better value on their own or with a third-party. When we believe a business is not core to our strategy to drive shareholder value, we undertake proactive steps, as evidenced by the recent sale of Aerostructures and the sale of our commercial healthcare and broadcast communications businesses in prior years. We will continue to assess our portfolio with the goal of enhancing shareholder value creation.

As a Rahul just described FY17 guidance, while we still expect revenue headwinds to persist, we also expect additional acquisition savings and our continuing focus on lowering cost to result in higher FY17 earnings. Our guidance anticipates a continuing resolution through the end of this calendar year, and the spending constraints it typically creates until the budget is passed, especially on our shorter cycle Tactical business.

Longer term, we expect positive momentum in Space & Intel and Electronic Systems to continue, and we also anticipate a recovery in the tactical market, driven by army and SOCOM modernizations as well as other International modernizations, such as in Australia and in the Middle East and Northern Africa.

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

## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions)

Pete Skibitski, Drexel Hamilton.

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

Good morning, guys.

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

Good morning, Pete.

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

The decline in US radio volume in the fourth quarter and kind of going into FY17, you guys have figured in expectations of a continuing resolution, is that softness kind of across all the services and across Special Forces or just the Army? And can you maybe characterize if the CR goes into first quarter of next calendar year, how much incremental pressure that might be?

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

Well, it is -- it was pretty broad across the services. It was not a special operations but it was pretty broad across the other services, mainly base-type business, resets, sustainment, spares, other things that we saw. And it's not really, in our view, a need-based push out.

It's really based just on some cautionary behavior on and expectations of a continuing resolution, which, again, we are expecting through the end of this calendar year. I won't speculate today as to what the impact might be if it moves beyond the end of December, but I think it would probably put some pressure on the back end of our year if the CR moves out beyond December.

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

Okay. I will just ask one more and get back in queue. It sounds like you factored the MUOS upgrade pretty substantially in your 2017 guidance. I think you said previously the money for that is already appropriated. Is that so, and if so, would there be upside to your guidance from that and maybe give us a sense of what the Army is thinking on that program specifically right now.

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

Well, it's really across the services and it's not so much Army driven. It's other services, but it's a -- we're making very good progress. Most, in fact, all of the certifications are in place. The testing is complete. We have interim NSA certification. Right now, getting the formal NSA search should happen over the next several months.

It's really administrative process more than anything and once we get the formal NSA cert, it should trigger some orders happening. We have about $10 million in backlog right now in MUOS and we do see it, as Rahul pointed out in next year, tens of millions of opportunities in MUOS. We still feel very, very good about that opportunity in FY17, Pete.

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

Okay, okay, great. Thank you.

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**Operator**

Howard Rubel, Jefferies.

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**Howard Rubel** - *Jefferies & Company - Analyst*

Thank you very much. I have two questions. First, talk for a minute about Critical Networks and there's two things. One is you are able to restructure CapRock so that it's profitable. Can you outline how you have -- what some of the accomplishments were and how you think about the sustainability of it? And then, also, can you talk about win rates in the service business, Bill?

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

Sure. Let me start with CapRock. The -- we exit the year about what we thought about $60 million in the quarter in CapRock energy. So it was down quite a bit year-over-year in the fourth quarter, probably around 35%; for the year in 2016, down about 25%. With oil sitting down in the low $40s now, we see a bit of incremental pressure, although there's some service companies out there that are expecting some recovery into 2017, maybe the back end of 2017.

We do see another step down next year. We were sizing it about 25%. We took some pretty aggressive restructuring actions, really, over the last 12 to 18 months but you recall pretty significantly as we exited Q2, and those are starting to take hold. We lost money in CapRock energy in Q3; we returned to profitability in Q4.

And that's part of the reason why you see the CN segment, the Critical Network segment, being a little more profitable in Q4; part of it comes from some turnaround in the CapRock business. So I think we've sized for next year. We expect to make money in CapRock energy next year, but we do see another step down in that segment, again, about 25%.

On the Services side, we were down 10%, 11% in the Services in the quarter for the year down, about 22%, in the Services side, mission sustainment, which was about what we had expected, maybe a little bit better in Q4 but about what we expected. We do see another step-down next year in the high single-digit range.

We have a pretty good pipeline of opportunities. We ended FY17 in that business with a book-to-bill of 1. So we're holding backlog going into next year. We had previously said about one-third of that business was up for recompete and was going to put some pressure into 2017; we're now guiding to that pressure into 2017.

But some of the recompetes are now behind us. I think we've faring pretty well; there's a few that are still ahead of us. What we're seeing here is that the recompetes, we're winning them but when we do win them, they are coming as, instead of single vendor, they are more multi-vendor or IDIQ instead of regular contracts. So we still have to compete for task orders. So we do still see some revenue pressure in 2017 in Services, but not quite as the downturn we saw in 2016, however.

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**Howard Rubel** - *Jefferies & Company - Analyst*

That's very helpful. And then your joint press release with JANA sales sounds to be very constructive. Can you elaborate a little bit on the dialogue and what you're looking for in the independent directors?

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

Well, first, it was constructive. They've become a major shareholder. We welcome input from all of our shareholders. We have very active dialogue with everybody. We reached an agreement to add two new independent directors to the Board.

And we talked in -- you'll read in the 8K and the agreement that we filed a little bit about that. One will be announced in early September; both will stand for election at our Annual General Meeting in October. But beyond that, I don't think I will comment on any other conversations with them or any other particular shareholder, Howard.

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**Howard Rubel** - *Jefferies & Company - Analyst*

I understand. Thank you very much.

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

You bet.

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**Operator**

Seth Seifman, JPMorgan.

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**Seth Seifman** - *JPMorgan - Analyst*

Thanks very much and good morning. Bill, I think around the time of the acquisition, you put out a long-term cash flow target, I think for FY19 of $1 billion for free cash flow. So the forecast for 2017 is $800 million. Is that target still operative and can you talk about the ways that you get there?

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

Sure. In fact, we feel very good, first off, about where we came out in FY16 with a lot of puts and takes above the $750 million guidance so we came in at $772 million. We feel good about how we delivered that, absorbing pretty substantial pension and cash integration costs, very good improvement at working capital as we had signaled we would have.

We continued to tightly manage our capital spending. So next year, we guided to about $800 million in free cash flow, with a little bit of a step-up in capital spending although we remain very, very tight on that at $175 million.

We still see a path to getting to $1 billion by FY19; that was a three-year goal that we set out. And it comes from the same things we've described before on this call, certainly, the integration savings role in this year and hit steady state, really going into 2018. We see lower cash integration costs.

We see lower cash interest expenses. We see some additional working capital performance improvements, and since we've closed about 50% of our floor space, or about 2 million square feet, we do see some additional capital spending efficiencies as we get further out in time. So those are the still -- they still remain, Seth, to be the key drivers of hitting $1 billion in 2019.

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**Seth Seifman** - *JPMorgan - Analyst*

Great, thanks. And just as a quick follow-up on MNVR, there was some talk in the press about in OT&E evaluation with -- they found some issues with it. Do you still expect it to go forward with an award this quarter?

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

Yes, we do. We do expect Milestone C occurring later this quarter. Just to go back a little bit, we had a very good user test back in October of last year. The Army validated the need for the mid-tier radio at 16.2 back in May so it was very good. It was -- you need the mid-tier to connect the upper and lower tactical tiers, and they have shown that.

They also showed which was the key intention of the test, was that you needed a radio like MNVR to operating in SATCOM-denied or degraded environments and it performed well. Our radio meets all the CPD requirements, and we do expect the Milestone C later this year.

The questions that were raised were really around weight, really swap in general and range. And we met the original -- we met the requirements. We do see opportunities to improve that over time.

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**Seth Seifman** - *JPMorgan - Analyst*

Great. Thank you.

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

Sure.

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**Operator**

Carter Copeland, Barclays.

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

We will come back around to Carter.

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**Operator**

Noah Poponak, Goldman Sachs.

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

Hi. Good morning, everyone.

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

Good morning, Noah.

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

Bill, I wondered if you'd speak to where you expect domestic and International legacy -- in the legacy Harris Tactical Radio business. Where do you expect book-to-bill to trend through your upcoming fiscal year?

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

Well, we're not going to give guidance on the book-to-bill. What we've given guidance on today is what we think is going to happen into the revenue environment. And we see the DoD business to be flat to up a little bit slightly, going into next year. We ended the year around $70 million, more or less in Q4.

You see it in the back of the Appendix in the DoD Tactical business. We see that same cautious behavior continuing into next year, but then on top of that, we see tens of millions of opportunities in two areas as Rahul mentioned, army modernization opportunities which would include the MNVR opportunity as well as on MUOS and that should bring us to flat to up slightly.

We do see another step-down next year in the International business. We see that -- our pipeline still remains pretty healthy in that business, but we do see that business down mid-teens going into next year. Not a lot really has changed in many ways since our Q3 release in terms of the overall sets of risks and opportunities that are still out there.

We still see some good funding on the horizon. But we see that business down a little bit going into next year. And maybe a little bit more color on this, as we look out into 2017, we see about one-third of that business is in Europe, which as you know, we've talked before in 2016 was coming off a pretty good record year; Eastern Europe and the Ukraine remain very, very solid.

We still see that strong going into 2017, but it will be down slightly from what was a record year. We see about one-third of the businesses in the Middle East and Africa, where we do expect to see a relatively slow pace to continue, revenue to be flat to down slightly. Iraq remains one of our biggest opportunities in the Middle East.

There's another country in the Middle East which we see a little bit of recovery offset that, but again, that Middle East/Africa should be probably down slightly to flat in next year. The balance of the business, or about 10% to 15% each in Asia Pac and Australia. Australia should be -- that region should be flat to up a little bit because Australia is going to come in a little bit stronger next year.

We see Central America, Latin America to be flat to up slightly a little bit. We do see Brazil a little bit weaker. We see Mexico a little bit stronger but that region up a little bit.

But really as we look out in the next year, the big challenge we're facing is really in central Asia, in particular, in Afghanistan, as a pretty big program runs from lots of new radios in the past to more sustainment in 2017 and beyond. And that's really the biggest piece of the headwind going into next year.

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

So I appreciate all that color; it's helpful. I think you're just starting your FY17; you've just given guidance for FY17 so it's a little unfair to go down this line of questioning, but I think that investors in the market are not particularly concerned with 2017 and are looking furthers out because you've won all these new programs that don't kick in until after 2017.

The defense budget is only just starting to bottom. And so there's a lot of potential positive prospects beyond 2017. But on the other hand, your bookings keep trending to be relatively soft. You're talking about softer DoD cautious buying behavior, which is not particularly consistent with, I guess, what a lot of other defense companies are saying.

And so, point being, there's just a lot of uncertainty around the growth trajectory beyond 2017, recognizing that's not the most fair question given where you are. I don't know if there's any way you can speak to those inputs, even directionally to give some people some comfort in that part of the model?

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

Sure. Look, while we're seeing some pressure in 2017, when you see us our down 1% to 3%, 1% to 4% next year, we've got two business segments that are coming up and coming off of a pretty good back half that's Electronic Systems and Space & Intel. So those are performing very, very well and we expect that to continue.

Within Critical Networks, we see our mission networks FAA business to be -- it has been strongest this past year; very strong in the second half of 2016, continuing up next year, good international opportunities so we see that continuing to grow going into next year. We think service is going to stabilize as we get beyond 2017 into 2018 so it won't be as much of a drag.

And then on the CS segment, we see that segment down next year, but when you look at the two things, one, the pace of awards and actions happening on army modernization, SOCOM modernization, those activities are moving quickly. Our Rifleman Radio is now through both customer test and qual test. The Manpack Radio is now through qualification test. They expect to go into delivery orders into early part of our Harris FY18.

SOCOM moves -- is moving nicely. We do see substantial budget upticks in 2017 from 2016, as well then in 2018 from 2017, so very good funding support for that. On the International side, the pipeline remains very, very strong; the needs are out there.

The funding is not moving at paces we had expected, but the strong need that is out there. The pipeline is pretty robust. And going out beyond 2017, we see markets like Australia to be quite significant and big contributors and we get into 2018. So we still believe that 2018 will be a growth year for Harris Corporation and I think we are positioning ourselves well to grow in that time period.

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

Okay, great. And just one final question. The remaining portfolio reshaping potential that you pointed to, is everything on the table there? Could we see entire reporting segments as part of that process? Is that at least in the scenario analysis or are we only looking at the smaller pieces of the business?

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

We're not going to comment on any specific analysis that's going on right now inside the Company. We're -- again, I wouldn't add more than what I was -- I said in my prepared remarks which I thought very carefully about. We're looking at this aggressively and dispassionately, making sure that we keep businesses that add value long-term to our owners and that's all we're prepared to talk about today.

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

Okay. Thank you.

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

You bet.

**Operator**

Gautam Khanna, Cowen and Company.

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

Yes thanks. I was wondering could you quantify -- you mentioned that some of the Q4 blips at RF Tactical are caught up in Q1. Could you quantify that for us first and then I have a couple of other questions.

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

Well, just in terms of just the math that we gave in terms of guidance, we said the Tactical business, legacy Tactical would be down high single digits. You can see it came down about 14%; just the math would indicate it's $65 million to $70 million that slipped out into FY17.

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

Okay. And that's caught up. Can you talk about the FMS task orders that you were talking about, having moved to the right a little bit? Size them for us and could you gauge where those are incremental year to year? It just sound like a, given the guidance, about mid-teens. (multiple speakers) What should we expect?

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

Go ahead. I'm sorry.

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

No. I'm just curious, I'm trying to square it because it looks like there's some things you're getting catch up, but the guidance is down quite a bit.

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

Yes, look the -- so again, about $65 million to $70 million moved out; a little more than half of that was International. A little less than half that was on the DoD side so on the International side, it was several different opportunities, about two-thirds of which really came out of the Middle East-Africa region.

And really got hung up by a late approval on the $1.77 billion IDIQ and then it just took some time to get the task orders through the system. And as we pointed out, we did recognize revenue for those opportunities here in July. And I wouldn't characterize it as anything more than what is incremental or not. We gave our guidance for 2017, we do see the International business to be down mid teens going into next year.

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

Okay, so just squaring that, mid-teens implies $140 million decline. You mentioned that the legacy DoD is flat to up. It may be a net down $120 million, $130 million, something like that. Could you help us understand what happens to core legacy RF Tactical margins in that scenario? I understand that the integration synergies comes from the overall Comm Systems, but are RF Tactical margins going to be down and if so, how much?

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

We've weathered this past year on a Tactical business, down about 14%. We weathered that downturn and had pretty good margins at [2016] and we expect to have good margins going into 2017 as well. Integration savings are a key component of that, Gautam. In fact, the significant relocation of the Fort Wayne production facility into Rochester was a Tactical Radio opportunity and those -- that's -- those savings are going to hit us in 2017 and that does backstop our margins in FY17, offsetting what would happen to be some pressure from top line coming down.

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

Okay. And then last one, Bill, could you give us an update on the size of your International and DoD legacy RF pipeline and also relatedly, you may have answered it. I may have missed it, the book-to-bill expectations at Tactical RF this year and perhaps any phasing, because it sounds like second half, you'll have some of those 2018 opportunities start to convert to orders.

I'm thinking JTRS Manpack Australia and the like, but I haven't heard much about the first half and I'm just wondering if you could calibrate it, overall Tactical RF book-to-bill first half versus second half? Thank you.

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

Thank you, Gautam. Look, I'm not going to give much color around book-to-bill for the year. For the Company overall, we do see a slightly better back half than front half, simply just by the nature of the expectations of the CR. It's going to be slightly back-end loaded, but not much unusual from what we've seen in the prior years, maybe a tick up in the back half from what we've seen before.

So I won't really size or shape the Tactical business for FY17. On the pipeline, the DoD pipeline still remains pretty healthy. It's at an $900 million to $1 billion size. We do start to see more of the modernization opportunities starting to come into the pipeline.

On the International side, the pipeline remains about $2.6 billion. We said last time, about $2.9 billion. The big opportunity we had in there that would then drove it to $2.9 billion was Australia; $600 million, we feel good about the opportunity. It's still out there. As we've gotten in detailed negotiations with Australia, they may split that into two pieces.

They may do $300 million, $350 million at the back end of our FY17. The balance may slip out a little bit beyond that. And that was the key driver of bringing down our International pipeline to about $2.6 million but it's still sitting at a very robust level, and which gives us some confidence of growth in FY18 as a Company overall.

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

Okay. I'm sorry. I said that was my last one. I did want to ask Rahul, if you could just talk about where the unfunded pension and OPEB now ends FY16 and what, if any, implications that has on cash contribution longer term? Thank you.

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**Rahul Ghai** - *Harris Corporation - SVP & CFO*

Our total pension deficit, Gautam, increased by about $100 million to $2.3 billion from $2.2 billion. And this includes both the pension and the OPEB liabilities. So we previously said our pension liabilities increased about roughly $180-ish million for every 25 basis points reduction in discount rate.

As the discount rate changed by 40 basis points, but that was partially offset by the contributions we had made and certain changes in the post-retirement benefits. So our total deficit ended at $2.3 billion, up $100 million from 20 -- where we ended last year. It really has no impact on our contributions because that's a different formula.

Our total contributions will go up a little bit next year because the discount rate at which we calculate with the contributions is coming down. And also, the rate of return on assets need to be factored in. So contributions are up about $10 million, $15 million year over year but that also gets offset by the cash reimbursements that we get from the government.

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

Thank you guys.

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

Sure, Gautam.

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**Operator**

Carter Copeland, Barclays.

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

All right. Can you hear me this time, guys?

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

We can hear you Carter. Yes.

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

Perfect. Malfunctioning mute button there. So just a couple of quick ones, as a lot of these have been asked. On the pension, Rahul, can you size for us where those incremental tailwinds went in the segments, just to kind of get a sense of what impact that had on the margins?

And then Bill, at least from a high level, I understand that it's classified, but this new win and new franchise that could be bigger longer term, can you help us from a high level just to understand the size and scale and maybe the growth prospects of what that is? Thanks.

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**Rahul Ghai** - *Harris Corporation - SVP & CFO*

Okay, so let me start, Carter, and Bill can take the second one. So the FAS pension benefit is, as you know, largely on the Exelis portfolio. So by the nature of that, that went to Space & Intel, ES and Critical Networks because that's where the majority of the FAS benefit is just given where the Exelis business happens to be in our business. So -- and you can see the margins in those segments did get a benefit from those FAS contributions, or FAS changes.

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

On the classified (multiple speakers) -- Go ahead, Carter.

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

I'm just thinking, if we assume 40%/40%/20% split between those segments to get a sense of what the underlying margin movement is; is that a fair split?

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**Rahul Ghai** - *Harris Corporation - SVP & CFO*

With the changes, yes, if you assume 40%/40%/20%, I don't think you'll be that far off in terms of those three segments.

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

Okay. Sorry.

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

And on the classified piece, you're right, we really can't provide a lot more color on that other than what we've talked about. But I'm very pleased and very proud of what the team has done over the course of FY16, certainly in the back half in our proprietary business, classified business. A lot of this, as it relates to using different capabilities acquired with Exelis, combining with what Harris legacy has, moving from sensors to systems to now providing end-to-end solutions.

And that allows us to have a different conversation with customers on where we can plug-in as a prime mission provider, and these things evolve over time. The team has done a fantastic job of articulating our newfound capabilities. And the customers recognizing that and providing opportunities back to Harris Corporation. So I really can't say much more than that, other than we're performing very, very well in a classified space with good back funding support and with a lot of good strong prospects into the future.

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

Great and one last clarification. I know you highlighted Iraq as an opportunity last quarter and it sounds like in your response to Gautam's question, Iraq is still an opportunity, so I guess are we to assume that none of that has entered the backlog just yet?

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

Well, I won't talk about what we necessarily booked in the month of July in terms by country, but it is an opportunity in FY17 what slipped from June and moved into 2017. There was -- you recall back when we announced our Q3 earnings, we recalibrated guidance for Tactical and part of it was an opportunity for Iraq that moved into 2017; that is still sitting out here. That is going to happen. There's funding support for that.

Iraq remains one of our biggest opportunities, certainly for next year but also more importantly in terms of longer term pipeline. There's lots of opportunities in Iraq. It comes both in the Ministry of Defense, Ministry of Interior; there's different funding support -- funding backstop support, but it's really a good opportunity for us going into 2017 in our Tactical business.

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

Great. Thanks, Bill.

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

You bet, Carter.

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

Operator, we will take one more question.

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**Operator**

Pete Skibitski, Drexel and Hamilton.

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

Thanks, guys. I guess, Rahul, I was wondering if you can give us the full depreciation and amortization forecast for FY17. And then, I mean, you guys did a good job of beating your free cash flow guidance in 2016 despite all the headwinds. So I'm just wondering if you could talk about maybe how much upside opportunity there could be in 2017 if we avoid some of the headwinds, incremental headwinds that we saw in 2016?

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**Rahul Ghai** - *Harris Corporation - SVP & CFO*

Yes, our -- we mentioned our amortization is roughly the same year over year on the Exelis deal. Beyond that, we would not like to comment. In terms of our cash flow, listen, we feel good about the $800 million. If you start -- if you look at the $770 million that we did this year with a tailwind that Bill mentioned on coming off the integration cost adjusted for Tact.

We do have some pension income that is non-cash, and then a little bit of CapEx changes and then working capital improvement; that gets us to about $800 million and we feel good about that. I really don't want to go beyond that at this point.

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

I don't think depreciation and amortization in total is changing in 2017 and 2016; it's about flat so it's not an incremental contribution in cash going into 2017, Pete, on D&A.

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

Okay, great. Thanks very much.

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

You bet.

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

All right. Thank you everyone. Appreciate it.

**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.