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HRS - Q2 2018 Harris Corp Earnings Call

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OVERVIEW:

Co. reported 2Q18 YoverY revenue growth of 6% and non-GAAP EPS of $1.67. Expects FY18 revenue to grow 3-4% and EPS to be $6.30-6.50.

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PRESENTATION

Operator

Greetings, and welcome to the Harris Corporation Second Quarter Fiscal Year 2018 Conference Call. (Operator Instructions) As a reminder, this conference is being recorded. It is now pleasure to introduce your host, Anurag Maheshwari, Vice President of Investor Relations. Thank you. You may begin.

Anurag Maheshwari *- Harris Corporation - MD of Asia-Pacific*

Thank you, Michelle. Good morning, everyone, and welcome to our second quarter fiscal 2018 earnings call. On the call with me today is Bill Brown, Chairman and Chief Executive Officer; 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 related discussion, please see the press release, the presentation and Harris' SEC filings.

In addition, discussions today will include non-GAAP financial measures, and the reconciliation of the non-GAAP 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 also will be available. With that, Bill, I will turn it over to you.

William M. Brown *- Harris Corporation - Chairman, President & CEO*

Okay. Well, thank you, Anurag, and good morning, everyone. Earlier today, we reported solid second quarter results with non-GAAP earnings per share of $1.67, up 21% on 6% revenue growth, including an incremental $0.21 benefit from the recently-enacted tax reform legislation. Excluding the benefit, non-GAAP earnings per share was up about 6%. Free cash flow increased 15% to $258 million, and we returned $143 million to shareholders, including $75 million in share repurchases.

We continue to build on first-quarter momentum to drive top line growth with orders up 13% in the quarter and 24% in the first half. So let me start with a little more color on growth drivers across the segments noted on Slide 4.

Communication Systems revenue grew 18% in the quarter, with tactical radio up 26% from strength in both DoD and international. DoD revenue increased 56% as the focus on readiness continue to drive demand. We booked about $100 million on radio revenue in the quarter from the Air Force and the Army as part of a multiyear plan to equip their security forces as they increase their presence overseas. For the first half, despite limited modernization activity, DoD orders nearly doubled, and revenue grew 26% on the back of sustained readiness demand.

Army and SOCOM tactical modernization programs continue to advance and remain well supported. We will start delivering HMS and Manpack test radios as the Army prepares for Field-based Risk Reduction in the spring of this year, and we expect an initial production award toward the end of our fiscal '18. The protest on the Army 2-channel leader radio was recently denied, and we expect an order soon on the IDIQ while we work with the army as it prepares for tests.

For the SOCOM 2-channel handheld, we've delivered our first set of test radios and remain on track to complete development this quarter and begin product deliveries in the fourth quarter. Overall, all programs are moving forward, and we continue to expect revenue to ramp, starting in fiscal '19.

In international, revenue increased 9%, primarily from better-than-expected recovery in the Middle East, where revenue was up by more than 50%, driven by modernization of security forces in Iraq, delivery of SINCGARS radios to Saudi Arabia and a technology refresh for a long-standing customer in the region.

In Iraq, our pipeline is over $0.5 billion, and we're beginning to see several opportunities break free as the country moves from grant-funded counterterrorism to border security, and eventually to command and control systems as they standardize across the forces and the Ministry of Interior. The solid first-half performance in the Middle East, combined with strength in Africa, drove international revenue of 1% for the half and book-to-bill greater than 1, excluding Australia.

Overall, for the first half of the fiscal year, tactical revenues increased 10%, orders grew 54% and book-to-bill was 1.6, resulting in a backlog increase of 59% year-over-year to $884 million. Within 50% of second-half tactical revenue is covered in backlog, up 10 percentage points from this time last year, giving us comfort in achieving our increased segment guidance.

In Electronic Systems, revenue increased 2% for the quarter, 6% excluding the $22 million impact of ADS-B. This was driven by strong double-digit growth in Avionics as we continue to benefit from higher volume and new content wins on F-35; the ramp-up on the U.K. robotics program; and growth in electronic warfare systems on legacy platforms, such as the F/A-18 and international F-16s.

Orders momentum continues to be strong in Electronic Systems and were up 37% for the second quarter. Similar to last quarter, Avionics orders more than doubled compared with the last year, as the ramp on F-35 continues, including the award of lot 11 for release systems and block buy of lots 12 through 14 for antennas.

For F-35, in the first half, we received orders of $300 million, which is significantly more than what we achieved in all of fiscal '17. In addition to F-35, we've seen strong first-half orders on both F-18 and F-16, receiving a combined $300 million for Avionics and electronic warfare systems. We expect the order momentum across these 3 platforms to continue in the second half. Overall, for ES, first-half orders grew 21%, book-to-bill was 1.3 and backlog increased 10% over the prior year.

In Space and Intelligence Systems, revenue was down 1% in the quarter, as growth in classified programs and commercial reflectors was offset by expected headwinds on environmental programs. Orders continue to be strong in the classified arena, with additional funding received for a smallsat program and a multimillion dollar award for advanced ground processing. And I'm pleased to note that our strong focus on program execution and operational excellence is strengthening our competitive position on key strategic programs. On GPS, we're executing well. And we've established a proven and reliable production cadence, delivering our fourth GPS III navigation payload in October and tracking well to deliver the fifth payload by the end of March.

We've also developed and tested a fully digital mission data unit, which puts us in a strong position to compete for the upcoming GPS III 11+ award and maintain our incumbency. Similarly, on the SENSOR program, the large ground radar sustainment effort for the Air Force, we continue to improve on-time performance, which has more than doubled since we acquired Exelis, resulting in improved customer satisfaction and positioning us well for follow-on opportunities.

For Space and Intel, first-half revenue was up 1%, orders grew by 9% and book-to-bill was greater than 1. Solid second-quarter results for the company capped an encouraging first-half performance, with revenue up 3% and growth across all 3 segments, order growth of 24%, book-to-bill of 1.3 and a backlog increase of 15% compared to the prior year.

This, combined with nearly 80% of back-half revenues in backlog or high-probability follow-on opportunities, a strong and growing pipeline and $8 billion of proposals outstanding, give us confidence despite a lengthened CR to tighten our revenue guidance to up 3% to 4% from 2% to 4% previously. We're maintaining company operating margin guidance of 19% to 19.5%. But within that range, we're planning an incremental investment of approximately $20 million in IRAD to strengthen our position and capture new market opportunities in areas such as smallsats, software-defined electronic warfare systems, open system avionics and robotics. These have been focused areas for several years. But due to our recent success and customer pull, we're increasing investment in these initiatives to drive innovation and affordability for our customers. We're also investing in human capital and making a onetime stock grant of 10 shares to all nonexecutive employees, our most important asset in driving long-term customer and shareholder value. And then finally, we anticipate pre-funding the pension plan by $300 million during our fiscal Q3. We're making these additional investments in the context of the recently-enacted tax legislation, which is a net positive for Harris and for the U.S. economy as a whole. We expect tax reform to reduce our effective rate by about 10 percentage points next year, with about half of that reduction impacting this year and adding about $50 million to fiscal '18 net income.

This benefit, combined with an improved revenue outlook and strong operational performance offsetting incremental investment, gives us confidence to increase fiscal '18 earnings per share guidance to $6.30 to $6.50 per share and free cash flow to about $900 million.

So let me now turn it over to Rahul to cover financial results in more detail before we open the call to questions. Rahul?

Rahul Ghai - *Harris Corporation - Senior VP & CFO*

Thank you, Bill, and good morning, everyone. Turning now to total company results on Slide 5. Discussions today are on a non-GAAP basis, excluding noncash charges in the quarter from a $52 million onetime write-down of deferred tax assets and a $12 million adjustment for deferred compensation, as well as prior-year Exelis acquisition-related charges. Revenue was up 6% during the second quarter, and operating income was down $6 million as higher volume and operational efficiencies were more than offset by contract adjustments in the mission networks business. EPS was up 21% or $0.29, including a $0.21 incremental benefit from tax reform. This benefit included a catch-up from the first quarter, resulting in 11-point reduction in the Q2 tax rate since the tax reform impact must be spread across all 4 quarters of our fiscal '18. For the first half, revenue was up 3%, and operating income was up 1% despite a $36 million unfavorable impact from the ADS-B program. Operating margin was 18.9%. Free cash flow was robust in the first half at $330 million, a 34% increase over the prior year.

On a last 12-month basis, adjusted free cash flow was $934 million.

Turning now to segment details on Slide 6. Communication Systems second quarter revenue was $489 million, up 18% versus the prior year. In addition to strong growth in tactical, night vision revenue was also up double digits, as the business continues to improve execution. Operating income for the segment was up 19% at $144 million compared with $121 million in the prior year, driven by higher volume, operational excellence and integration savings.

Orders grew by 21%, resulting in a book-to-bill of approximately 1 for the quarter. For the first half of the year, segment revenue was up 7%, and operating income was up 10%. Operating margin of 29.1% was up 70 basis points versus the prior year. Segment orders increased 44% in the first half, and book-to-bill was 1.5. Notably, the book-to-bill was above 1 for each of the 3 businesses in the segment: tactical communications, PSPC and night vision. We've continued to include historical information for tactical orders, revenue and backlog as supplemental information at the end of this presentation.

On Slide 7, Electronic Systems revenue was $584 million, up 2% for the quarter. The $33 million decline in segment operating income was driven by contract adjustments in the mission networks business, including a $22 million headwind from the ADS-B program, increased R&D expense and unfavorable mix, partially offset by strong performance on electronic warfare programs and the benefit of higher volume in Avionics.

First half segment revenue was up 2%, while operating income was down 14% or $36 million as the increase in volume was offset by ADS-B headwind and an increase in R&D. Operating margin remained strong at 18.7%.

On Slide 8, Space and Intelligence Systems segment operating system was up 7% on revenue decline of 1%. For the first half, revenue for the segment increased 1%, and operating income was up 8%, resulting in 120 basis points of margin expansion from productivity and incremental pension income.

Moving to slides 9 and 10 for full-year guidance. As Bill indicated, we now expect revenue to be up 3% to 4% versus up 2% to 4% in the prior guidance due to increased strength in Tactical Communications and in Avionics. We're increasing the EPS guidance from a range of $5.85 to $6.05 to a range of $6.30 to $6.50, driven by better-than-expected operational performance and benefits of the tax reform, partially offset by reinvestment into certain key franchisees. Strong execution is expected to deliver an additional $0.13 through EPS on higher volume and strong program management, partially offset by unfavorable mix in Electronic Systems. We will reinvest $0.12 of that into innovation and affordability and bid and proposal activity across the corporation. Tax reform and other tax efficiencies will drive the effective tax rate in fiscal '18 down to approximately 23%. This, combined with operational changes, results in a $0.45 EPS increase. Total company margin is still expected to remain robust at 19% to 19.5%. We are tightening free cash flow guidance to approximately $900 million from a range of $850 million to $900 million, reflecting the cash benefit from tax reform.

Turning now to outlook at the segment level. In Communication Systems, we now expect revenue to be up 5% to 7% versus up 3% to 5% previously, driven by strength in Tactical Communication and Night Vision. Operating margin guidance range of 19.9 -- -- sorry, operating margin guidance range of 29.5% to 30.5% remains unchanged. In Electronic Systems, we now expect revenue to be at the top end of the previous range, up 4% to 5% versus up 3% to 5% previously from better-than-expected outlook in Avionics and electronic warfare. Operating margin is now expected to be between 18% to 19% versus 19% to 20% previously due to increased R&D and bid and proposal investment and unfavorable mixed shift from products to program businesses.

Space and Intelligence revenue guidance remains unchanged at flat to up 1%. Operating margins are now expected to be between 17% to 18% versus 16.5% to 17.5% previously, driven by higher productivity and strong program execution, partially offset by reinvestments in R&D.

On Slide 11, we're updating the guidance for tax and share repurchases. We have completed the $150 million of share buyback that we had initially planned, and now expect to repurchase an additional $50 million in the second half for a total of $200 million in share repurchases for the fiscal year.

And with that, I would like to ask the operator to open the line for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Robert Stallard with Vertical Research Partners.

Robert Alan Stallard - *Vertical Research Partners, LLC - Partner*

Bill, obviously, a very strong order intake in the first half of the year. I was wondering how sustainable do you think this sort of order intake is as we roll forward into the future, and whether you're seeing any change in the lead time between when the order is placed and when you expect to ship the product.

William M. Brown - *Harris Corporation - Chairman, President & CEO*

Well, we start out with a very good first quarter because we booked Australia, I recall, in Q1. So a very strong book-to-bill in Q1, which really led into a good first half. For the year, as we said last time, we do expect a book-to-bill of greater than 1. And as we see a CR turn into a healthy budget into what we hope to be a very healthy defense spending line in fiscal '19, my expectation is we'll continue to see orders grow beyond '18 into '19 and, hopefully, beyond '19. So we've got a good start. We're building some good momentum. We're seeing lead time in order conversion opportunity to order about the same. I know there's an important effort focused on shortening the acquisition time line, both in U.S. DoD as well as on the FMS side. We haven't seen anything yet, except for a couple of pretty quick turn investments in readiness that -- for more urgent requirements. But I know the department is focused on both accelerating DoD purchase as well as getting FMS contracts done a lot faster than have been before.

Robert Alan Stallard - *Vertical Research Partners, LLC - Partner*

Just a quick follow-up. You mentioned that the Middle East was coming better than maybe you'd been expecting in the second quarter. What about some of the other regions, how did they fair?

William M. Brown - *Harris Corporation - Chairman, President & CEO*

Well, certainly, the Middle East was very good. We had anticipated the year to be up probably 40%-ish in the Middle East. It was a little bit stronger in Q2 than we expected. We're seeing the pipeline velocity in the Middle East a little bit faster than we had expected, which I think is good news. And hopefully, we'll see that trend continuing into the back half. So the Middle East has been very strong. Again, keep in mind, it's coming off of a relatively low base. So that's going to be pretty good. It's pretty broad-based. So Iraq is very important in the Middle East. Saudi has been a good opportunity. We see good opportunities in Northern Africa as well, and as well as Sub-Saharan. So overall, pretty good trajectory in the Middle East. We will see the Asia Pacific region grow pretty aggressively this year, probably about the same, about 40%, principally due to Australia, but also because of some other countries in Southeast Asia. So again, good momentum in Asia. We'll see a tick-down this year in Europe. It'll be down probably double digits off a record year last year, a record second half in Eastern Europe. And then Central in Latin America as well as Central Asia will likely be down pretty significantly this year. So overall, international, on a revenue basis, we still see it where we did before, flat to down slightly, although the DoD business will be stronger this year.

Operator

Our next question comes from the line of Jon Raviv with Citigroup.

Jonathan Phaff Raviv - *Citigroup Inc, Research Division - VP*

Can you just provide something of an update on some of your free cash flow goals post the tax reform act? I think, previously, we've talked about, about $1 billion. You're approaching that. Any thoughts on where that might go over the next few years?

William M. Brown - *Harris Corporation - Chairman, President & CEO*

Well, we will see this year as we went up by, at the center point, $25 million from between $850 million to $900 million. So now, we're guiding at $900 million. Tax reform this year is about $50 million. But because of elongated continuing resolution, some of our revenue will price-flip to the back end of the year. And what that means is we might have a little pressure on collection, so which is why we conservatively boosted our free cash guidance to about $900 million. Going into next year, with tax reform, we see an incremental $50 million to $75 million of free cash just on tax itself. So that puts us in the $950 million to $975 million range with earnings growth and working capital performance. We can see a path to getting to $1 billion in fiscal '19. And as we think about how we deploy that, overall, we don't see much of a change to our overall philosophy on capital deployment. We'll continue to remain balanced and shareholder-friendly, and making sure we maintain a healthy balance sheet. Rahul did mention that in the near-term, we're going to increase our share repurchases this year from $150 million to $200 million. We will pay a debt that's due. It's about $0.5 billion in April. We're going to pre-fund our pension. We anticipate doing that here on our third quarter. We'll borrow to do that. And as we go into '19 and beyond, longer-term, not much of a change in our overall priorities. We'll continue to complete -- to fund all of the great investments we have internally in R&D and capital spending. We're going to continue to pay a very good dividend, which we've been paying pretty aggressively over the last decade or more, and any balance that's remaining on free cash will be deployed to M&A or share buyback. And if you think about the numbers, we'll be generating probably a couple of billion dollars between '18 to '19. It gives a lot of firepower for both share buyback as well as potential M&A.

Jonathan Phaff Raviv - *Citigroup Inc, Research Division - VP*

Okay, great. And then, also, on the CapEx question, you mentioned that the allocation priorities might not change too much. We're seeing some other companies really get ahead of what I anticipate to be greater growth in terms of rent in CapEx. How are you guys thinking through your capital investment problem?

William M. Brown - *Harris Corporation - Chairman, President & CEO*

Yes, Jon, the difference with Harris is that over the last 5 or 6 years, we have invested in capital in the company. If you go back 6 years, we were over $300 million this year at $130 million. So a lot of the investment that we've made were to upgrade our infrastructure, upgrade our capacity. We've got a relatively brand new tactical radio facility up in Rochester that's running at 60% or so utilization. So we don't have any internal capacity constraints relative to satisfying the increasing demand. But what we have done is step up over the last 5 or 6 years in R&D. We're doing that again, internal investments in R&D. Harris spends more than -- on a relative basis relative to revenue than anyone on our segment, and we're taking it up even further. We've been running at about 5% of revenue. And this year, we'll take it up to 5.2%, 5.3%. So we continue to invest very heavily in both R&D and over a period of time in capital spending. Our capital this year of $130 million is about 2.2% of revenue. We feel pretty good about that.

Operator

Our next question comes from the line of Rob Springarn with Credit Suisse.

Robert Michael Spingarn - *Crédit Suisse AG, Research Division - Aerospace and Defense Analyst*

I wanted to see if we could just go to your Slide 12 on Tactical Com history. You talked about, Bill, your strong first quarter intake. You've now got record revenues in the second quarter. And combining that in with the DoD backdrop you just talked about and the madness push on readiness, how do we see Tactical Comms going forward? Do you think revenue -- quarterly revenues can move up from here, given that your backlog is still at record levels?

William M. Brown - *Harris Corporation - Chairman, President & CEO*

No, we do see quarterly revenue increasing in the back half. We see continued strong growth in DoD. We had a very good start, very good orders here in the second quarter, again, a lot of it driven by readiness, quick turn orders. As we look into the back half, we see continuous, strong double-digit growth. We were guiding to be up mid-teens last quarter. We're now going to be up in the low 20s on tactical revenue DoD, and that feels like a pretty good spot to be. And we probably have -- overall, for tactical, more than half of our second half that's currently in backlog flowing out in backlog in the back half. But keep in mind, on the international side, we've got a few orders in there that are longer duration like Australia. It will be rolling out over the next couple 3 years, and we'll see part of that moving in the back half. So we will see growth in the back half in international on a sequential basis. Year-over-year, it will be down a little bit because we're coming off a pretty strong compare last year with good performance in Eastern Europe. I think, overall, that's how I see us tracking over the back end of this year.

Robert Michael Spingarn - *Crédit Suisse AG, Research Division - Aerospace and Defense Analyst*

Okay. So we don't see a peak in Tactical Comms anytime soon. That's kind of where I was going. And then I have a similar question on F-35 on your long-term outlook. So...

William M. Brown - *Harris Corporation - Chairman, President & CEO*

Yes, we don't see a peak. We're not at a peak by any stretch on the tactical business. I think we're -- in my view, certainly on the DoD side, we're at the front end of what we hope to be a steep curve that's coming. And based on just what we see happening in modernization, both in the Army, DoD, eventually in the Marine Corps, out a couple of years, if you look at the 5-year budget, and that, by the way, has not been changing very much, you'll see a good ramp in DoD. We expect to capture a good chunk of that. On the F-35, we're still in low-rate production. And we're on Lots 11 and 12, and we're still ramping up. So we think that that's going to continue to grow over the next couple of years.

Robert Michael Spingarn - *Crédit Suisse AG, Research Division - Aerospace and Defense Analyst*

I was going to say, do you have an idea, timing-wise, when you would get up to the 150 ship sets per year, which I believe is -- what Lockheed is targeting as the mature peak rate?

William M. Brown - *Harris Corporation - Chairman, President & CEO*

Yes. It's probably about 1 year or 2 from now. Yes, we're probably at the front end. We're probably -- certainly, on the common component side, the stuff that goes in the aircraft, we're probably on the front end. And on the release systems, we're probably on the back end. We're at Lot 11. So they come in different pieces and ramp at different rates. But I would say, on the common components, we'll probably hit that a little bit faster than we'll be on the release systems.

Rahul Ghai - *Harris Corporation - Senior VP & CFO*

This is Rahul, Rob. So just generally, we are a little bit ahead of Lockheed because we are -- as Bill mentioned, we are on LRIP 11 on the release systems and 12 on the Avionics. So we are generally -- we are ahead of the normal ramp-up curve.

Robert Michael Spingarn - *Crédit Suisse AG, Research Division - Aerospace and Defense Analyst*

Okay. And then I just wanted to ask. You've mentioned a couple of times reinvestment. And while you've said there's not a big C change in CapEx plans, you do have some higher R&D here and there. Could you just review the franchises that you're putting that money into? Where should we look for Harris to really be developing any incremental strengths beyond those you already have?

William M. Brown - *Harris Corporation - Chairman, President & CEO*

Look, we've been investing pretty aggressively in our tactical business over the last number of years, and that probably is about 35% of our IRAD spend. So that has remained high and will continue to remain high, and it'll be fully funded at a very, very good return. But where we're stepping up is in Electronic Systems as well as in the Space and Intel segment. In both segments, they were a little bit below tactical, and they're coming up quite dramatically over the last couple of years. And it's going to be an area in like open systems Avionics. So we have opportunities to change out Avionics from newer platforms as well as next-gen platforms in Avionics. We're developing software-defined electronic warfare systems, both for legacy platforms, but also perhaps onboarding on to the newer-generation aircraft. We're investing in robotics. We won a pretty good-size contract for EOD in the U.K., and we think there's just good opportunities to grow robotics beyond U.K. into other international markets maybe and into the U.S. DoD over time as well. And then on the space side, we've been penetrating the market for small satellites and hosted payloads. We've been winning some awards in the classified community, and we're going to continue to invest to win in those areas. These are very, very clear trends that we're seeing, and we're investing ahead of the curve.

Operator

Our next question comes from the line of Sheila Kahyaoglu with Jefferies.

Sheila Karin Kahyaoglu - *Jefferies LLC, Research Division - Equity Analyst*

I was hoping we could maybe revisit Communication Systems and the longer-term margin profile of the business. As you ramp up on new opportunities and also new business wins, how do you think of the puts and takes for the longer-term margin profile?

Rahul Ghai - *Harris Corporation - Senior VP & CFO*

Sheila, so I think the margin, we feel good about remaining in the range that we have, that we've guided to this year, the couple of things that will kind of move around. As the volume ramps up, there will be incremental benefit from drop, too, just given the tactical margins being higher than the segment margin. But also, the mix is skewing a little bit towards more program business like that in Australia. And also the fact is the DoD modernization is going to come in lower, at least in the initial stages than the margin that we currently have. So you put that -- all that together between volume benefit and some mixed shift and lower-margin DoD business relative to where we are right now in the initial period, we feel good about where we are right now. I think that's where we expect at least '19 to be.

Sheila Karin Kahyaoglu - *Jefferies LLC, Research Division - Equity Analyst*

Okay, got it. And then just one more. I think, Bill, you mentioned the $8 billion of proposals outstanding. If you could elaborate on some of the big opportunities. The big one was $500 million within Iraq. If you could talk about some of the other items.

William M. Brown - *Harris Corporation - Chairman, President & CEO*

Well, it's really, really across the business. When I look at what's happening in Electronic Systems, we've got a very strong pipeline to upgrade, for example, international F-16s for EW systems. We've got opportunities to continue to grow our business in air traffic management. We've got opportunities on the Avionics side. On the space side, there's tremendous opportunities in growing in the classified community. The budgets on the classified side are growing mid-single digits. In the areas where we have been competing, they're slightly better than that. We have found a good way to penetrate that and be competitive. And we're seeing a lot of opportunities start to enter our pipeline on the classified side. So it's pretty broad-based across the company when I look at it. And of course, we've got good opportunities sitting in the tactical side. The tactical pipelines are running around $2.5 billion on the international side, about $1.4 billion, $1.5 on the DoD side. So look, Sheila, it's really across the company where we see good strength in the pipeline.

Operator

Our next question comes from the line of Gautam Khanna with Cowen and Company.

Gautam J. Khanna - *Cowen and Company, LLC, Research Division - MD and Senior Analyst*

A couple of questions. First, I was wondering if you could give us some directional color on cash pension contribution on fiscal '19.

Rahul Ghai - *Harris Corporation - Senior VP & CFO*

Gautam, we're not expecting -- with the pre-funding that Bill just mentioned, the $300 million that we're thinking of doing in Q3, we don't expect any pension contribution now until 2025. So that will pre-fund the pension for the next several years.

Gautam J. Khanna - *Cowen and Company, LLC, Research Division - MD and Senior Analyst*

Okay. And just the cash flow guidance for the year, free cash flow guidance, does that exclude the $300 million?

Rahul Ghai - *Harris Corporation - Senior VP & CFO*

Yes, it does.

William M. Brown - *Harris Corporation - Chairman, President & CEO*

No, sorry, the $900 million does not include a pension pre-funding, just to be perfectly clear on that.

Gautam J. Khanna - *Cowen and Company, LLC, Research Division - MD and Senior Analyst*

Got it, okay. How would you size the initial JTRS Manpack production award that you're expecting in fiscal Q4? How large do you think it might be between the 2 suppliers? And any color on how that...

William M. Brown - *Harris Corporation - Chairman, President & CEO*

Yes, it's still working through -- it's still working its way through Army acquisition, and it would be for a couple of BCTs. My understanding is it could be in the range of about 3,000 units. We don't price that, but it will be about 3,000 units. And we do expect that it will be split basically 50-50 between us and the other player in the IDIQ in that range. Again, it's still working its way through Army acquisition. So we'll know more as that decision is made.

Gautam J. Khanna - *Cowen and Company, LLC, Research Division - MD and Senior Analyst*

Okay. And then in subsequent years, what do you anticipate that today? Is it going to be 3,000 units per year? Or what do you think is happening?

William M. Brown - *Harris Corporation - Chairman, President & CEO*

No, we think that this is -- yes, we think it's going to grow from there. When you look at just where the '18 budget's at, at $355 million, up from, I think, it was only $275 million or so last year. So the budgets for HMS includes the rifle and our own on-and-off swing. So I would expect that revenue will ramp in '19 on the Manpack and continue to grow thereafter as really at the front end of the sort of the recapitalization and the modernization of the tactical radio franchise within the Army.

Gautam J. Khanna - *Cowen and Company, LLC, Research Division - MD and Senior Analyst*

And I know you didn't want to talk about price. But in the fiscal '18 request, you can see the government's estimate of price of around $62,000 or so per unit. Is that -- should we expect it to be far off of that mark? Or is there a reason to think it's going to be a lot lower?

William M. Brown - *Harris Corporation - Chairman, President & CEO*

I think that what you don't see is what the Army builds into those cost estimates. Sometimes, it's just the radio, plus accessories, plus Army program management costs. It could be vehicular adapters. It could be a variety of things. So it's not a pure number, Gautam. And so I would take it with some grain of caution.

Gautam J. Khanna - *Cowen and Company, LLC, Research Division - MD and Senior Analyst*

Okay. Last question. Just on the F-35, you mentioned picking up more content on it. Could you refresh us on what your revenue per F-35 is sitting at today?

William M. Brown - *Harris Corporation - Chairman, President & CEO*

Yes. We're sitting today at about -- roughly about $2.2 million per ship set. We have a number of pieces. One is the release systems. So the bomb release or charge-release systems for the F-35. We have a variety of common components, meaning they're common across the 3 different variants, liquid cool racks and power supplies. We do the antenna as well. And we, very recently, within the last year, won the electronic unit for the Panoramic Cockpit Display. That was about $320 million. That's the front end of its development. So that'll onboard probably several years from now. And then we won about 1 year ago, or within the last year, the Aircraft Memory System upgrade with a contract value at about $140 million. So overall, we're running $2.2 million. But we do see opportunities to drive that up if we're successful in winning the open system mission computer, which will be down-selected again to a final win or 1 of the 3 down-selected companies today, but the final one probably within the next couple of years. So we're pretty hopeful about additional content on the F-35.

Gautam J. Khanna - *Cowen and Company, LLC, Research Division - MD and Senior Analyst*

Well, I said that was my last. I wanted to sneak one more in. You mentioned share -- cash deployment opportunities, and Exelis now is well digested, I would say. What are you thinking in terms of acquisition priorities? Is there much of a pipeline? How do you think about valuations? Any color on what the next 5 years look like for the company?

William M. Brown - *Harris Corporation - Chairman, President & CEO*

Well, I think, look, M&A is going to be part of what we want to do longer-term. I think we did a good job of buying Exelis at a good part in the cycle -- a point of the cycle. And we integrated well, and we paid down debt. We've paid down our pension obligation. We're going to be at probably 85% funded. So we've done a very good job, I believe, in integration and managing our balance sheet. Now we're generating very strong cash. The working capital turns have improved pretty dramatically, both for Harris as well as for legacy Exelis, and you're seeing that come through in our free cash guidance. As we get into next year, we'll have a little bit of debt to pay down. It depends upon the length of time we borrow to fund the pension, but it does leave quite a bit of capacity for buybacks for M&A. And the way I look at it is we'll evaluate things very, very carefully. The prices are relatively high, and we don't need to buy anything to be scaled. We think we're scaled in a place where we want to be. We like the position we happen to have, but we'll continue to evaluate opportunities to bolt on, arrive to the company in the key franchises that we're in today. Other than that, I don't think we have much more to say.

Operator

Our next question comes from the line of Pete Skibitski with Drexel Hamilton.

Peter John Skibitski - *Drexel Hamilton, LLC, Research Division - Senior Equity Research Analyst*

Bill, I would like to talk more about Communications Systems, Bill, if we could, from a different perspective, and I kind of have a compound question. A lot has been written on kind of the incremental Russian military threat to ground threat, and it sounds like the U.S. Army as well as Congress are pretty concerned about that. So I'm wondering, are you sensing recently more kind of threat-driven incremental demand in radios? And at same time that's going on, we're hearing recently that the fiscal '19 budget could be really attractive, maybe approaching 7% growth over -- per year over the next couple of years if you kind of average it out. So between the incremental threat out there and the inflecting budgets, Communication Systems, would you err on the side of the outlook for Comms being closer to high single digits now than the prior mid-single-digit outlook you gave? Or is international side -- is there just not enough visibility on the international side right now?

William M. Brown - *Harris Corporation - Chairman, President & CEO*

Well, I think we'll wait until we see where the '19 budget actually drops and what the fight looks like this to say if we're going to change any prospective for long-term growth in communications. I saw the same reports about the '19 budget. But again, until that actually drops, we don't know the size of it and, even more importantly, the mix across the different programs. But to your point about what's driving communications, tactical radio revenue, certainly, last year, it was a lot around investments in Eastern Europe in Comms to help drive interoperability across NATO forces and with U.S. forces. And that was a big part of the surge we saw last year in Eastern Europe, and it continues at a pretty good pace even this year. And when you step back and look at some of the investments that the DoD is making now today in radios and maybe even some of the hesitancy going forward is really rethinking exactly what kind of radio comps they want, what sort of waveforms they need. What's the bandwidth? Are they anti-jam? Are they at low probability of interception and detection? They're changing their thinking about it. And it spills from not just communication, but also in electronic warfare business, and is a fundamental driver for why we're seeing increased investment and growth outlook in electronic warfare. It's all around how do our forces and our partner forces compete in places like Europe given the Russian threat. So that is the backdrop for a lot of the trends that we've seen in the business and, frankly, a lot of the investment that we're talking about that we've made and are making now in our business to enhance our communications and spectrum warfare capabilities and drive opportunities here to communicate broadly, convey information, but to have then anti-jam. So they hop very quickly, as well as the LPI/LPD. So long answer, Pete, but that's really the backdrop of what's happening, driving an important trend across all of our Comms and EW businesses.

Peter John Skibitski - *Drexel Hamilton, LLC, Research Division - Senior Equity Research Analyst*

Okay, that's helpful. Let me ask a couple of ancillary questions to that. The new WIN-T strategy, as of today versus last quarter, do you have any greater clarity as to kind of what comes next post WIN-T, and if there would be an incremental benefit to Harris or same as last quarter for the most part?

William M. Brown - *Harris Corporation - Chairman, President & CEO*

It's about the same as last quarter. We're working very closely with the Army as they rethink what they want the structure of the network, the architecture of the network to look like. It was a good result that they've separated the upper tactical network, meaning WIN-T, from the lower tactical, meaning the radios. And they're moving forward with radio purchases. We do have components on the upper tactical WIN-T system. We have the radio, the Highband Networking Radio. We have the waveform, which is HNW. We have a new version of the waveform that's sitting out there now in the repository. I do believe that no matter what they do on the upper tactical network, there's a role for Harris to play. In fact, I think it may be increasing as opposed to decreasing. The radio we've developed and the waveform that's been developed gives you a much faster rate of transmission. There's more nodes. It's a more mobile system, solving a lot of the issues that the Army's had with WIN-T. So Pete, on balance, I think we're probably as good, if not better positioned, on WIN-T now than we were before.

Peter John Skibitski - *Drexel Hamilton, LLC, Research Division - Senior Equity Research Analyst*

Okay. great. Very helpful. If I could just sneak in one last one. I apologize. But on the EW front, this next-generation jammer, the low band, I'm starting to see more out there on that. Is it still early there in terms of award date and sizing? And is this C now, is this currently maybe one of the bigger competitive opportunities for ES?

William M. Brown - *Harris Corporation - Chairman, President & CEO*

This is one that we've looked at for some time, and we continue to look at it. I don't have much to say in terms of when that procurement will likely come through. It's been talked about for the last, at these, a couple of years that I've heard about it. So we'll stay back. We'll look at it and evaluate. Do we participate directly or with another party in this space as we've done before on a prior opportunity on that platform?

Operator

Our next question comes from the line of Seth Seifman with JPMorgan.

Seth Michael Seifman - *JP Morgan Chase & Co, Research Division - Senior Equity Research Analyst*

As you start delivering Manpack radios to the Army, and they go through risk reduction and testing, are there any sort of outstanding technical challenges? And if so, what are they? Or do you feel like we've kind of gotten through all that, and it should be pretty smooth testing for you?

William M. Brown - *Harris Corporation - Chairman, President & CEO*

I think the requirements are likely to get changed a little bit over time, Seth. To be honest with you, I think the fundamental hardware of the radio won't change, but the beauty of these radios is that they are software-defined. Their features, their functionality can be changed and upgraded over time with software downloads. And we've seen that happen on the 117G. We'll see the same thing happen on our version of the Manpack. So the capabilities will change over time. What we have demonstrated and our competitor in the space have demonstrated through the customer test is basic functionality of the radio and the waveforms. And what they're now testing are some of the deferred threshold requirements like the ability for the radio to use the MUOS waveform, a very complicated waveform. Now we've perfected that in putting it into the 117G. I don't expect that to be a problem and how it works in the Manpack. So they're just going to test them. The deferred threshold requirements is what's happening right now. But I do believe, over time, these requirements will continue to shift as the threat environment shifts.

Seth Michael Seifman - *JP Morgan Chase & Co, Research Division - Senior Equity Research Analyst*

Great. And then maybe last one. Bill, when you look at the things they're considering for the organization of space acquisition in the Air Force and moving that into sort of its own dedicated area, how do you think about the implications for Harris?

William M. Brown - *Harris Corporation - Chairman, President & CEO*

Well, look, we're an important player in the space side, and we work very closely with our Air Force colleagues. We have very good relationships there. And I think, frankly, since we bought Exelis and expanded our capabilities there, and by the way, improved dramatically our performance on GPS, I think our relationships there, our credibility has improved. We've got a very, very strong team in Colorado Springs. It's a pretty broad-based set of capabilities, both on the unclassified as well as the classified domain. And I think it's -- I think we're well-positioned. If they consider moving and creating a separate space for us, the way I look at this is if you want to make improvements and really drive something like improvements on our space infrastructure, space architecture, you're separating that and making it the sole function of a part of the Air Force or separate from the Air Force could only be -- drive good benefits. Because that will drive more investment in the area, and I think we would see some of the results of that. So I think if anything, that would be a positive for Harris over time.

Operator

And our final question comes from the line of Josh Sullivan with Seaport Global.

Joshua Ward Sullivan - *Seaport Global Securities LLC, Research Division - Director & Senior Industrials Analyst*

I think you had mentioned, on the electronic warfare side, upgrades for the international F-16s. Is there any way to size that? And is there a similar opportunity for maybe F-18s?

William M. Brown - *Harris Corporation - Chairman, President & CEO*

Well, we do provide the -- what we call the IDECM system for F-18s. That's both for U.S. as well as international variants of the F-18. And we've been receiving some pretty healthy orders very recently on F-18s for U.S. Navy and Australia, and we do see opportunities to continue to grow that. On the F-16, it'll go through the FMS process. There's probably, I don't know, 8 or 10 different countries around the world that use F-16s. And we are the legacy EW provider on international F-16s, not domestic ones. So we do see quite a long tail of opportunities to well over $0.5 billion to upgrade international F-16s.

Joshua Ward Sullivan - *Seaport Global Securities LLC, Research Division - Director & Senior Industrials Analyst*

Okay. And then on night vision, up double digits, it's been a legacy technology. Just what's driving that? And then is that sustainable going forward?

William M. Brown - *Harris Corporation - Chairman, President & CEO*

Yes, it's come off a pretty long decline going back, I don't know, 5 or 7 years with the wind-down of some of the wars. And I think we -- last year, we hit a bottom in fiscal '17. We're down, I don't know, 10% or so in fiscal '17. But we've seen, through '17 and now into '18, very, very strong orders. Good book-to-bill backlog is coming up. In the first half, we're up double-digit. Q2 was strong. We'll be up double-digit for the year. A lot of it is -- I mean, there are some new technologies that are being played. A lot of it's refresh and resets of tubes and goggles for the DoD as well as international partners. And there are some new technology investments that we have made and are making that we'll continue to see some, I think, good traction in the marketplace. But I think a lot of it is refreshed upgrades of existing goggles.

Rahul Ghai - *Harris Corporation - Senior VP & CFO*

And where we are seeing growth and part of the reason why we are seeing growth is because we've improved our operational performance. So our throughput is higher, and we've been able to take the costs lower. When we bought Exelis, we couldn't ship the product for about a year because the team was under short notice. We've been very working very hard to resolve some of the operational issue. And that's helped us win a very large share, both domestically and some of the international opportunity. That's starting to grow.

Joshua Ward Sullivan - *Seaport Global Securities LLC, Research Division - Director & Senior Industrials Analyst*

Okay, great. And I'll just switch over to tech for the last one. You mentioned the Rochester facility is at about 65%. How long do you think it takes you to get to kind of that 85% level?

Rahul Ghai - *Harris Corporation - Senior VP & CFO*

Well, it depends on how quickly the volume ramps up and the DoD modernization kicks in. That's what's going to determine -- I think the point that Bill made earlier was the fact that as -- even with incremental DoD volume, we don't see a need to make a capital investment in the facility. We -- business is still off at peak. I mean, I think we did $1.7 billion, $1.8 billion going back a few years. So we still have ways to go before we reach 100% capacity utilization there.

William M. Brown - *Harris Corporation - Chairman, President & CEO*

And even as we fill up the factory today, if we do hit a limit, there's things that we do in the factory that we can always find -- we can always outsource to effectively increase capacity in the building. So we don't have any constraints that we see in the near term or the medium term.

Anurag Maheshwari - *Harris Corporation - MD of Asia-Pacific*

Thank you, everyone, for joining the call this morning, and please do not hesitate to get in touch with me for any additional questions. Have a great day.

Operator

Thank you. This concludes today's teleconference. You may disconnect your lines at this time. Thank you for your participation, and have a wonderful day.
