31-Oct-2017

Harris Corp. (HRS)

Q1 2018 Earnings Call

CORPORATE PARTICIPANTS

Anurag Maheshwari
Vice President-Investor Relations, Harris Corp.

William M. Brown
Chairman, President & Chief Executive Officer, Harris Corp.

Rahul Ghai
Chief Financial Officer & Senior Vice President, Harris Corp.

OTHER PARTICIPANTS

Peter John Skibitski
Analyst, Drexel Hamilton LLC

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Gautam Khanna
Analyst, Cowen and Company, LLC

Carter Copeland
Analyst, Melius Research LLC

Robert M. Spingarn
Analyst, Credit Suisse Securities (USA) LLC

Jason Gursky
Analyst, Citigroup Global Markets, Inc.

Noah Poponak
Analyst, Goldman Sachs & Co. LLC

Sheila Kahyaoglu
Analyst, Jefferies LLC

Robert Stallard
Analyst, Vertical Research Partners LLC

MANAGEMENT DISCUSSION SECTION

Operator: Good day, ladies and gentlemen, and welcome to the Harris Corporation's First Quarter 2018 Fiscal Year Conference Call. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session, and instructions will be given at that time. [Operator Instructions]

I will now like to turn the conference over to your host for today, Anurag Maheshwari, Vice President of Investor Relations. You may begin.

Anurag Maheshwari
Vice President-Investor Relations, Harris Corp.

Thank you, Sonia. Good morning everyone and welcome to our first 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 the related discussion, please see the press release, the presentation and Harris' SEC filings. In addition, today's discussions 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'll turn it over to you.

William M. Brown

Chairman, President & Chief Executive Officer, Harris Corp.

Thank you, Anurag, and good morning everyone. Earlier this morning, we posted Q1 fiscal 2018 results and we're off to a good start to the year. Earnings per share was up 8% to a $1.38 on flat revenue, margins expand 70 basis points to 19.2%, free cash flow improved by $50 million, and we returned $144 million to shareholders through share repurchases and an increased dividend, our 16th consecutive annual increase. The highlight of the quarter was orders, increasing 33% to a record $2.3 billion with the book-to-bill of 1.6. So, let me highlight a few of these key wins across the three segments indicated on slide 4, starting with Communication Systems.

We finally secured the much anticipated $260 million order for Australian Phase 3 modernization, the first stage of a multiyear program with total potential value of over $1 billion. As you know, the Australian MoD has standardized on Harris' networking technology and, to-date, we've shipped about $800 million in radios. And we're leveraging that incumbency into developing and building a broader integrated network. This is part of an important strategic initiative to expand our addressable market and we're replicating it in other geographies.

In Eastern Europe, we received a further $52 million, an order from Ukraine, as part of the Ukraine Security Assistance Initiative to modernize communications to meet emerging threats in the region, building on very strong orders' performance last year. In the Middle East and Africa, we anticipated a recovery in 2018 and then the quarter orders were more than double the prior year with a $39 million order from Iraq and $46 million from Kenya. Overall, international tactical book-to-bill was well over 2 and was still greater than 1, excluding Australia.

In DoD, we also saw increased demand with orders growing about 40%, including more than $100 million focused on readiness. A couple of notable awards include: $36 million from the Air Force for upgrades of their legacy communications equipment to software-defined radios to support multi-mission operations; and $38 million from the Marine Corps for radios with MUOS capability to enable high quality satellite communication on expeditionary missions. On Army modernization, as I mentioned on the last earnings call, we received an order for 101 HMS Manpack test radios from the Army at the beginning of Q1, and we expect to start deliveries later this quarter. With the down-selected two vendors now accomplished, we're working with the Army as they prepare for field-based risk reduction in the spring of 2018.

DoD Tactical book-to-bill was also well above 1 in the quarter and overall Tactical Communications backlog is now $879 million, up 66% from the prior year and 78% sequentially. Excluding Australia, backlog is up 25% sequentially and 17% year-on-year. Public Safety and Night Vision also had strong orders, resulting in Communication Systems having record orders of about $825 million and book-to-bill of 2. Following the close of the quarter, we received a $765 million sole-source IDIQ award from the Navy for Falcon III and next-generation radios, replacing a contract that was completely exhausted in April. This value is more than double the previous contract and aligned with the Navy's budget request to ramp up Marine Corps modernization efforts over the next few years.

In Electronic Systems, we continued to see strength in our Electronic Warfare business and we received a $133 million contract for U.S. Navy and Australian F-18s, continuing a 20-year relationship in enabling legacy platforms to perform more advanced missions. We also provided the EW system for international F-16s, and in the quarter, we received $47 million, an additional funding from Morocco to complete the upgrade of their entire fleet. And we have several additional international opportunities in the pipeline.

In the Avionics business, we continued to ramp production for the F-35 with a $63 million order for LRIP 10 release systems. In addition, we expanded our international footprint with key wins in Singapore and Turkey for smart carriage and release systems on international F-16s. These smart racks can carry two payloads of up to 1,000 pounds each and have our innovative and patented electronics enabling direct communication between the aircraft and the payload.

In C4ISR, we leverage our classified robotics expertise, and we were awarded a contract worth up to £55 million from the UK Ministry of Defense to provide robotic systems to support explosive ordinance disposal missions. The UK MoD is a global leader in EOD and our state-of-the-art product delivers real-time haptic feedback and unparalleled range of precision control. We're excited about our offering, and expect other countries to follow the UK's lead as they upgrade EOD capabilities. Overall, Electronic Systems' book-to-bill was 1.5, with both Electronic Warfare and Avionics above 2.

And then finally in Space and Intel, we had a number of significant wins, driving a segment book-to-bill of 1.4, with continued strength in the Classified domain and in our commercial reflector business. Let me provide a little color where I can on a couple of them. On our Q2 call last year, I noted a new franchise emerging from an $80 million Classified contract that we described then as a ground-based adjacency. We knew this program had the potential to grow into several hundred million dollars and, after a successful start-up, we were awarded a $34 million follow-on contract in the first quarter, further solidifying our position in this new franchise area. In addition, I noted last quarter that investing in R&D and innovating ahead of customer need enabled us to win two Classified small sat programs.

These Pathfinder missions have proven successful, as our customers move towards disaggregated, more affordable, and responsive space solutions, and we received an award this quarter that has the potential to grow to more than $100 million over the next two years.

And then finally, in our commercial space business, we received our largest order for a single commercial satellite covering four reflectors, bringing total orders to eight over the past two years. Our commercial reflector pipeline remains robust, and we expect these recapitalization and expansion trends to continue through fiscal 2018.

So overall, we're seeing positive momentum across the company, and I'm pleased with our strong orders growth, driven by sustained internal R&D investments over the past several years. This strong start to the year gives us confidence in our full year guidance and reinforces our view that we're at the beginning of a multiyear growth inflection.

Let me now turn the call over to Rahul for details on the financials. Rahul?

Rahul Ghai

Chief Financial Officer & Senior Vice President, Harris Corp.

Thank you, Bill, and good morning everyone. Just a quick reminder that fiscal 2018 results are compared with prior year non-GAAP figures, which excluded acquisition-related costs. Total company results on slide 5. Revenue was about flat, with growth in Electronic Systems and Space and Intelligence offset by lower revenue in Communications Systems. Operating income was up 3% and EPS was up 8%. Free cash flow grew by $50 million to $72 million.

Turning now to first quarter EPS bridge on slide 6. EPS grew by $0.10. The expected $0.08 headwind from the ADS-B program transition was partially offset with disciplined capital deployment in fiscal 2017. Strong segment performance delivered $0.12 of accretion from solid program execution, incremental integration savings, higher pension income, and lower costs. Benefit of higher volume in Avionics, Battle Management Systems, and Classified space was offset by lower Environmental and Communication Systems volume.

Segment detail on slide 7. Communication Systems revenue was $410 million, down 5%. Tactical Communication revenue was down 5%, with DoD down 2% from lower Airborne radios volume. International Tactical revenue was down 6%, as substantial growth in the Middle East, primarily from Iraq, was offset by the expected declines in Central Asia and in Central and Latin America, due to a tough year-over-year compare; and though slightly down, Europe remained strong, driven by Eastern Europe. Public Safety and Night Vision were both down mid-single digits. Segment operating income was flat at $118 million, but margin expanded 140 basis points to 28.8%, as lower cost and operational efficiencies more than offset the impact from lower volume. Historical information for Tactical orders, revenue, and backlog is provided in the supplementary material.

Moving to slide 8, Electronic Systems revenue was $540 million, up 1% versus the prior year. Excluding the impact of ADS-B program transition, revenue was up 5%. This was driven by the ramp in UAE battle management systems program and growth in Avionics across several platforms, such as F-35, F-22 and F-18. Segment operating income was down slightly to $109 million, and margin was down 50 basis points to 20.2%, a solid performance across the segment, and ongoing focus on operational excellence offset a $14 million headwind on the ADS-B program transition.

Slide 9, System and Intelligence (sic) [Space and Intelligence] (12: 18) revenue was $466 million, up 3%. Classified business was up 8%, and Environmental revenue declined double digits, in line with expectations, as some programs trended down. Segment operating income was up 10% to $87 million, and margin expanded 130 basis points to 18.7%, driven by strong program performance and higher pension income.

Moving to slides 10 and 11 for full year guidance. Guidance for fiscal 2018 remains unchanged, with EPS in a range of $5.85 to $6.05, up 6% to 9%, including benefit from $150 million of share repurchases for the year, with $75 million completed in the first quarter. Total company revenue guidance is unchanged in a range of $6.02 billion to $6.14 billion, up 2% to 4%. Communication Systems is expected to grow 3% to 5%, with DoD Tactical up double digits, from increased focus on readiness and incremental modernization volume. International Tactical is still expected to be flat to down slightly, with growth in the back half of the year as the Australia modernization program ramps up.

Electronic Systems is expected to be up 3% to 5%, with growth in Avionics, Electronic Warfare, and Battle Management Systems. Space and Intelligence is expected to be flat to up 1%, as strong revenue growth in the Classified area will be partially offset by the headwind from the environmental programs. Total company operating margin guidance remains unchanged in a range of 19% to 19.5%. We also continue to expect $850 million to $900 million in free cash flow for the full year. The first quarter tax rate of 27.7% benefited from the stock-based compensation accounting standard that we adopted in the first quarter of fiscal 2017. We still expect a full year tax rate of about 28.5%. The remaining three quarters are expected to average 28.8% varying quarter-to-quarter depending on specific tax timing differences.

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

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question comes from the line of Pete Skibitski of Drexel and Hamilton (sic) [Drexel Hamilton] (15: 13). Your line is now open.

Peter John Skibitski
Analyst, Drexel Hamilton LLC

Q

Good morning, guys. Nice quarter.

William M. Brown
Chairman, President & Chief Executive Officer, Harris Corp.

A

Hey. Good morning, Pete.

Peter John Skibitski
Analyst, Drexel Hamilton LLC

Q

Hey, Bill, was revenue kind of in line with your expectations, or if it was a little bit light, was it just timing or maybe CR related?

William M. Brown
Chairman, President & Chief Executive Officer, Harris Corp.

A

Yeah, look, I think we're pretty pleased with where we happen to be in the first quarter coming in at about flat. I'm very, very happy with where we were on orders. Orders were very, very strong. And as you look at the balance of the year, we've got fair amount of the backend of the year, it's now covered in backlog or in firm – or follow on, high probability follow-on orders. So, it's actually quite good. When we just look across the businesses, CS came in at down 5%. So, we saw a couple of opportunities shift into Q2, but we see though the balance of the year being very, very strong. Electronic Systems came in at 1%, but when you exclude the impact of ADS-B, it would be up 5%. So, that's a pretty substantial drag in the quarter and we'll see that again in Q2. And then Space coming in at 3% for the first quarter is above the full-year guidance and again reflects some good trends are happening at the business. So overall, I think we're pretty pleased with where we happen to be in the first quarter.

Peter John Skibitski
Analyst, Drexel Hamilton LLC

Q

Okay. Fair enough. And then just last one, Bill, for you, I was wondering if you can make some comments on some of the consolidation we've seen in this space, UTX buying Collins, Northrop buying OA, obviously, it's going to have some impact on the communications markets, small satellites, that kind of stuff. And so I'm just wondering how you see it, does it put you at a competitive advantage, or disadvantage rather ass some of these big guys get bigger or do you feel like maybe you're just more nimble and can maybe move faster than those guys? Just curious on your comments.

William M. Brown
Chairman, President & Chief Executive Officer, Harris Corp.

A

Yeah, Pete, look, I think from my perspective at Harris, we don't see any change to our game plan. We have a healthy amount of respect for the competitors we have in this space and the moves that they're making. But we feel we've got good scale position in the franchise areas we happen to be participating in. We spent a number of years investing in our franchises and focusing our businesses where we know we could be successful and winning based on technology. So we feel pretty good. We watch what's happening in the industry. But we feel good about the position of Harris Corporation and where the budgets happen to be going, and I think the future is very bright for Harris.

Peter John Skibitski
Analyst, Drexel Hamilton LLC

Q

Great. Thank you.

Operator: Thank you. And our next question comes from Seth Seifman of JPMorgan. Your line is now open.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Great. Good morning. Thanks very much.

William M. Brown
Chairman, President & Chief Executive Officer, Harris Corp.

A

Hey, good morning.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Bill, we had a lot of developments in the tactical comms area over the last couple of months. I wonder if you could address just broadly kind of two of them. One being how you think the changes in sort of the upper end of tactical and having to do with WIN-T and what that sort of means for Harris over time? And secondly, the comments that the Army has made recently basically suggests that they're looking to incorporate more capability into their communications capabilities faster. And how you think that Harris can address these capabilities and whether you see the Army kind of looking at all to new entrants to try and deliver any of this capability and if there are any new entrants who can?

William M. Brown
Chairman, President & Chief Executive Officer, Harris Corp.

A

Well, I think, very, very good questions. I think you're referencing a lot of the discussions going over the last six months to eight months, maybe a little bit longer than that, led by the Chief on the future of the Army architecture, the resiliency, the concerns about maneuverability in a variety of other things, they commissioned a study. The study came out with the findings. The Army has deliberated on that over the summer; in fact, engaged industry in lots of ways in conversations around that. And then there was some recent testimony in September in front of what are the subcommittees of the House Armed Services Committee, talking about some directions the Army wants to move in.

First of all, in the upper tactical system that mainly relates to WIN-T, we are a provider of some components on WIN-T. We'll provide the high-band networking radio as well as HNW waveform, which we've developed. Frankly, as I look for ways of making that system more resilient, more maneuverable that could flow down to some opportunities to Harris to upgrade its HNW waveform and HNR radio, which we're proceeding with today.

In terms of the Army wanting to put more capabilities into the tactical radio with the tactical internet faster, frankly works directly in our favor in many ways and I think is a strong foot stomp on the commercial model that Harris has been known for: the ability to quickly embed commercial technologies, continuously innovate, developing new capabilities, fielding them very quickly, investing ahead of the curve and building headroom on our radio so that you can on board new waveforms, new technologies based on where the market is moving or threats are changing.

So that works very much in favor of the model that Harris, I think, has been known for is very, very strong at. So, overall, I think this will eventually be a good outcome for the company. There's been some deliberation over the last six months, but I think it's starting to become clear as to where the Army wants to move. They clearly have made a strong statement in support of the manpack radio. They've made a strong statement in support of the two-channel Leader Radio. They want to become more SOCOM like, which again goes back in support of Harris. So, I think overall this could shake out to be good news over time for Harris.

Seth M. Seifman
Analyst, JPMorgan Securities LLC

Q

Great. Thanks very much.

William M. Brown
Chairman, President & Chief Executive Officer, Harris Corp.

A

You bet, Seth.

Operator: Thank you. And our next question comes from Gautam Khanna of Cowen and Company. Your line is now open.

Gautam Khanna
Analyst, Cowen and Company, LLC

Q

Yes, thanks. Couple of questions. First I was wondering, could you give us the legacy RF tactical orders and sales in the quarter, just so we have them?

Rahul Ghai
Chief Financial Officer & Senior Vice President, Harris Corp.

A

So, as we mentioned I think on the last call, we're not going to track it that way. We're just going to provide now combined results for the tactical radio business between Harris and Exelis. As we've combined and integrated the business, operationally, we're running it as one. Our sales forces are now combined. So, even internally, we've just stopped tracking between Exelis and Harris, and just tracking it just as the tactical radio business and we have the details in the supplementary material for the overall business.

William M. Brown
Chairman, President & Chief Executive Officer, Harris Corp.

A

Yeah, and I don't think your adding in Exelis really changes the trends very much, frankly.

Gautam Khanna
Analyst, Cowen and Company, LLC

Q

All right. Couple of things. One, I was wondering if you could give us your – the guidance didn't change on a net basis, but are there any puts and takes within it, like Australia, you are expecting $60 million of sales this year, is that still the expectation? Any comments on kind of – beneath the actual net numbers, has there have been any changes as a consequence?

William M. Brown
Chairman, President & Chief Executive Officer, Harris Corp.

A

Yeah I think, we – you know what? Yeah, you're about right on, on Australia that should be about to flow through in the year. Overall, we still see good growth on DoD, up double-digit for the year. And in international, as Rahul said in his prepared remarks, flat to down slightly, we still see a very strong pipeline. It's about $2.3 billion. We see the Middle East and Africa region, perhaps being a bit incrementally better in the year than we thought, just a couple of months ago, it's going to be up significantly double-digit and a little bit better than we had thought, and again we're seeing good opportunities flow through in Iraq. We are seeing that almost doubling over the course of the year.

The U.S. government support there is actually quite strong. We know Saudi is going to come up, off a very low base from last year, mainly because of the [indiscernible] (23: 06) product, the SINCGARS product that's going to flow through this year. North Africa looks good. We see Kenya looking pretty good. The UAE is pretty strong. The only place it's really soft in the Middle East will be in Jordan, but again overall, Middle East is a little bit better. Asia-Pacific is just a little bit better as well than last time, again up significantly double digits, Australia is a key part of it. There's a couple of other markets in Southeast Asia that are quite strong. So, APAC a little bit better.

Maybe Europe is about the same, maybe a little bit worse over the course of the last couple of months. We had a good start, [ph] new booking (23: 38) in Ukraine was a big deal for us, but Romania is going to be some pressure in the year, Poland is going to be some year-over-year pressure in the year. And in CALA and Central Asia, both look a little bit weak and we knew they will be weak, but probably incrementally, but weaker than we thought before.

Gautam Khanna
Analyst, Cowen and Company, LLC

Q

Okay. And, Bill, just following up on Pete's question about consolidation, you guys have been buying in a lot of stock. I'm curious, I mean, what is the M&A pipeline looking like for you guys as an acquirer now that the balance sheet is in a lot better shape and the Exelis integration is effectively completed. Are you looking at stuff and if so kind of what types of properties interest you in terms of size, capability, any color you can give?

William M. Brown
Chairman, President & Chief Executive Officer, Harris Corp.

A

Well, I really can't give you much color. You're right, we have completed Exelis integration. Our balance sheet is getting stronger. We've got a little more debt to pay down at the end of this year, about another $550 million in fiscal 2018. I think we've proven our creds if you will on how we bought a company at a good part of the cycle. We're disciplined in what we paid and integrated it very, very well. So, the team is looking at a variety of different opportunities, none of which are must-haves that could help us accelerate in some of our key franchise areas, but I don't believe today that we need to acquire to be successful. We're going to be opportunistic We'll be very focused on where we buy. But we're just starting to look a little bit more, but again it won't be in an area that's outside of our core space.

Gautam Khanna
Analyst, Cowen and Company, LLC

Q

Okay. Thanks a lot, guys. Good luck.

William M. Brown
Chairman, President & Chief Executive Officer, Harris Corp.

A

Sure.

Operator: Thank you. Our next question comes from Carter Copeland at Melius Research. Your line is now open.

Carter Copeland
Analyst, Melius Research LLC

Q

Hey. Good morning, guys.

William M. Brown
Chairman, President & Chief Executive Officer, Harris Corp.

A

Good morning, Carter. Welcome back.

Carter Copeland
Analyst, Melius Research LLC

Q

Hey, thanks. Good to be back. Couple questions for you. One, Bill, I just want to ask Seth's question another way, just to get at the kind of risk here. As you think about the deliberations that the customer has had here, are there factored bookings I would say in your plan at the latter part of this year that have some sort of risk if the customer moves slower than expected in terms of deciding what the network architecture is supposed to look like holistically? Just trying to get a sense of whether there's incremental risk here to the inflection that you've talked about in the growth?

William M. Brown
Chairman, President & Chief Executive Officer, Harris Corp.

A

We think the Army is – first of all, across the DoD, they're moving money into some of their procurement accounts. We see readiness picking up. This is a bit more aggressively than we thought just a couple of months ago. There's a lot of conversation about equipping new security forces, and that is going to, we believe, help us in the year.

We have very little in the year on modernization. It's up from last year. We had a good start to the year on selling the MUOS waveform. We expect this year to be about $50 million and 80% of that or so was booked in Q1. So that's pretty strong, but we've sort of derisked what we expect to see coming out of the Army manpack. It's largely just the [indiscernible] (26: 54) radios that we have shipped. We do see the SOCOM handheld radio beginning to ship in the back half of the year. That's going to ramp into 2019.

But as I sit here today, and based on -as I look at our backlog and backlog roll-off, in the tactical business largely, we probably have about 50%, or just about 50%, of the backend. So Q2 through Q4 revenue that's now in backlog and will flow out. So we feel better today looking at the backend of the year, Carter, than we did last year at this point in time. So overall I think we're relatively well calibrated in the year.

Carter Copeland
Analyst, Melius Research LLC

Q

Great. That's great color. And then, Rahul, just two quick ones. With respect to the margin strength in ES and Space and Intel, were there any net favorable EAC adjustments to note in those? And then the second one is, given the potential for tax reform, how are you guys thinking about potentially prefunding a slug of the pension? Thanks.

Rahul Ghai
Chief Financial Officer & Senior Vice President, Harris Corp.

A

Yes. Yeah, good question, Carter. So on the EAC adjustments, overall, it's kind of similar to where we were last year same time, so really no difference. I think both Space and ES had good operational performance. And kind of Space had a little bit of award fee timing that, those things fluctuate quarter to quarter. And ES had some – a slightly favorable fixed price content mix and some close-out on fixed price programs. So those things helped in the quarter, but overall, we feel good about where the margins happen to be.

And on your second question, on the pension, we contributed $400 million last year. So we had about 80% funded. So we have to be – which we feel relatively good about. And the second part is, so given that, we'll keep – and if interest rates move by about 25 basis points, our pension deficit cuts down by like $160 million. So a point of interest rate movement is going to cut our pension deficit by half. So we're going to continue to monitor that, and think about what that means on when we make pension contribution, if we choose to do so. Given our fiscal year ending, we have a little bit more time than others do, in terms of – if we have to do something extra on pension. But right now, we feel good about where we are in terms of funding.

William M. Brown
Chairman, President & Chief Executive Officer, Harris Corp.

A

And I think you might have mentioned about tax as well, Carter. I think we're hopeful that tax reform does occur. I think every one point on effective tax rate is worth about $0.08 for us. So net-net I think, if that moves forward, I think it would be a positive for Harris.

Carter Copeland
Analyst, Melius Research LLC

Q

That's great. Thanks, guys.

William M. Brown
Chairman, President & Chief Executive Officer, Harris Corp.

A

Sure.

Operator: Thank you. Our next question comes from Rob Spingarn of Credit Suisse. Your line is now open.

Rahul Ghai
Chief Financial Officer & Senior Vice President, Harris Corp.

A

Hey, Rob.

Robert M. Spingarn
Analyst, Credit Suisse Securities (USA) LLC

Q

Good morning.

William M. Brown
Chairman, President & Chief Executive Officer, Harris Corp.

A

Good morning.

Robert M. Spingarn
Analyst, Credit Suisse Securities (USA) LLC

Q

Good morning. So, Rahul, I had a couple of clarification questions I wanted to ask you. The first one being in the Space and Intelligence business. What is the Classified growth in the guidance, if you remove the headwind?

Rahul Ghai
Chief Financial Officer & Senior Vice President, Harris Corp.

A

So our Classified growth is about roughly mid-single digits, around 5%, year-over-year in our Space guidance.

Robert M. Spingarn
Analyst, Credit Suisse Securities (USA) LLC

Q

Okay. And then, just in the cash flow, you had – I think it was a source of around $107 million in other cash from ops. I can't recall if you described what that was already. I just wanted to follow up on that. And then, Bill, I have a radio question for you.

William M. Brown
Chairman, President & Chief Executive Officer, Harris Corp.

A

Sure.

Rahul Ghai
Chief Financial Officer & Senior Vice President, Harris Corp.

A

Yeah. So on cash, listen, good start to the year. We are up $50 million year-over-year in the quarter. And as expected, we had some working capital headwinds as we over-delivered $50 million in Q4. So we kind of expected that. And that got offset by some refunds on tax payments we made last year, and some cash tax timing differences. But on a last 12-month basis, we had about $900 million of free cash flow, and feel good about delivering $850 million to $900 million for the year.

Robert M. Spingarn
Analyst, Credit Suisse Securities (USA) LLC

Q

Okay. Okay. Bill, moving back to where Seth and Carter were going. I just wanted to ask a little bit more about JTRS, just given that we've just had this network vulnerability study with the Army and having just visited [ph] AUSA et cetera. (31: 31) One of the things we're hearing is that the radios, the tactical radios, are vulnerable to jamming and that there is a scaling up issue where only a certain – you can only get to a certain number of radios, I think it's something like 31, before they begin to jam in the field. And so I wanted to ask you, what's your comment on that? Where are we technically? And is there generally an issue with the hardware being able or mature enough to process the software-driven radio? Or are we not quite there yet? Is that really the core of the issue in developing this program?

William M. Brown
Chairman, President & Chief Executive Officer, Harris Corp.

A

No. It's a very, very complicated question that you're asking. But effectively, we've been in the business for several decade delivering radios, and have been nearly standardized across the DoD on our AN/PRC-117G, AN/PRC-152 Alpha radios, and are field proven. And we've been developing and working on the next-generation manpack radio, the single-channel Rifleman Radio, the two-channel handheld radio, the mid-tier radio. We're selling them all around the world. And even some of the newer product is being sold both within and outside of the DoD.

Look, the technology continues to move, the threat environment continues to change, and the radios have to be adaptable over time, given those current trends. And I think what the Army has realized is that you cannot take a JTRS program and 10 years or 11 years ago set a specification five years before the first iPhone is launched, and set a specification and hope to field it 11 years later and have it be relevant. It has to be very nimble, agile, flexible, procurement process, and you have to be able to upgrade frequently.

And in fact that's where the Army is moving, that's where SOCOM has moved, and that's really the commercial model that Harris I think is distinctively good at. We develop headroom in the hardware of our radios such that when new threats come up or new waveforms that could be low probability of interception or low probability of detection or [ph] ATG (33: 46) in waveforms that you can on-board them into that radio in the existing hardware.

It's exactly what we did by putting the MUOS waveform onto our existing 117Gs. MUOS was not even contemplated on a 117G when we first started fielding it eight years ago, but our great waveform engineers up in Rochester were able to customize that waveform with a simple software download on a drive to drop it into a 117G. That's the beauty of this particular model.

So to your comments and concerns, yeah, there's been a lot of question around this. The threat environment is changing, the technology is moving. But we believe that the adaptability of our model, our engineering investments in our products, we think we're going to be well positioned no matter where the Army or for that matter any of the other services go. So, hopefully, I'm addressing your question, Rob. It's a very complicated one, but I do believe that this ultimately reflects back on the value of the commercial model that Harris is very good at.

Robert M. Spingarn
Analyst, Credit Suisse Securities (USA) LLC

Q

Well, you are, Bill, and it is very complex, with all that said, and I think you started to do this in the answer to Carter's question. Do you have a sense of how many manpack radios you'll ship total this year and next year? Is there a way to quantify this? And can we figure out when the annual production lot competition will begin?

William M. Brown
Chairman, President & Chief Executive Officer, Harris Corp.

A

In terms of the specific number that we'll ship this year, again we're under contract on the multi-channel manpack for 100 units – 101 units and they're going to ship back into this quarter and into early Q3, so early first quarter of calendar 2018. And they'll start to do the field-based risk reduction probably in the April-May timeframe, and that's sort of the current operating model.

Now the down-select really effectively has happened, it's us and Rockwell Collins, and we're both aligned in moving the Army forward and ready to go. And I think that voice common from two competitors in this space I think is resonating with the Army. So if anything that could encourage that procurement to move faster rather than slower. So I think that's kind of where we see it at the moment.

Robert M. Spingarn
Analyst, Credit Suisse Securities (USA) LLC

Q

In your plan, do you have a sense of when that production work would start, the two of you?

William M. Brown
Chairman, President & Chief Executive Officer, Harris Corp.

A

In terms of the full rate production?

Robert M. Spingarn
Analyst, Credit Suisse Securities (USA) LLC

Q

Yeah, yeah.

William M. Brown
Chairman, President & Chief Executive Officer, Harris Corp.

A

It's probably the backend of our fiscal '18, maybe into early fiscal '19. Look, I think the Army still wants to field right out of the gate six BCTs. And that could happen in two, in four, it could happen in all six. We don't really know exactly what they're going to end up doing, but that's probably more likely a fiscal '19 revenue event for us as opposed to fiscal '18.The order could happen in the best of cases towards the back end of fiscal '18.But that's kind of where we see it right now. But when you look at the budget and where the Army wants to move, even the recent testimony it had in September, all was in the favor of moving forward at significant quantities of the HMS Manpack. So I think it's very encouraging what we're seeing over the last couple of months.

Robert M. Spingarn
Analyst, Credit Suisse Securities (USA) LLC

Q

Okay. Thank you.

William M. Brown
Chairman, President & Chief Executive Officer, Harris Corp.

A

You bet, Rob.

Operator: Thank you. Our next question comes from the line of Jason Gursky of Citi. Your line is now open.

Jason Gursky
Analyst, Citigroup Global Markets, Inc.

Q

Can you hear me okay?

William M. Brown
Chairman, President & Chief Executive Officer, Harris Corp.

A

Sure, Jason. Good morning.

Jason Gursky
Analyst, Citigroup Global Markets, Inc.

Q

Okay, great. Good morning. Bill, I wanted to go back to the Space business for a moment, if we can, and have you talk a little bit about some of the dynamics that are going on there, both in the classified and in the commercial side of things. On the classified, just give us a sense of where you're seeing longer-term growth trends going, maybe the scope of those growth trends here over the next few years? And then on the commercial side, the DoD has been discussing moving towards a more commercial procurement model, particularly on the communications side of things. I was wondering how Harris is going to potentially play in that and kind of what that dynamic means just generally speaking for the satellite industry? Thanks.

William M. Brown
Chairman, President & Chief Executive Officer, Harris Corp.

A

Sure. Yeah, let me maybe hit a couple of the key points and, Rahul, if you have anything to add, jump in. About two-thirds of the Space business is in the classified domain. We see the budgets up sort of mid-single digits. We see that continuing over the next number of years, as far as out we can see and have visibility to it, the classified budgets are coming up. And we get a little bit of color within the topline, and we can see where the money is being spent. And I feel that it's growing faster in areas that Harris has developed capability, so our high end exquisite sensors as well as our pretty innovative, creative, small sat type solutions. And so I feel very good.

We're all set for the year. The classified business will be up mid-single digits in Q1.It was up a bit stronger than that. We continue to see good, solid order trends and the pipeline here is quite good. The commercial business of the Space and Intel business, which is mostly commercial reflectors and GPS, that business will also be up pretty strong this year about double-digit. And, again, we talked about some of the awards we have seen.

In that commercial reflector business, we've got a strong global share. It's a commercial model-driven business where we invest our own R&D to develop that offering. We sell it into the marketplace. It performed exceptionally well on orbit, almost no failures with very, very high margins. And we have been running at about two reflectors a year over the last six years. And over the last two years we were at about four per year. So it's kind of doubled and we see another five or so that we're bidding opportunities in our fiscal '18.So we continue to see that commercial reflector business ramp.

The place that we're seeing some softness in the year is really in the environmental solutions business. We've talked about that over the last couple of quarters. Part of it is program transition where we're moving from the build of the GOES-R satellite system. So the onboard optics as well as the ground processing system is moving into sustainment. And then we're seeing just some budgetary pressure from where the Trump administration wants to go in environmental sciences. So we've factored that into our guidance, we see the environmental business which more or less is about $350 million to $400 million in size, being down mid-teens for the year. So we saw that in Q1, we see that at the balance of the year and beyond kind of stabilizing a little bit. So that's kind of where we sit today. The pipeline overall for that Space and Intel business is pretty robust, it's up about 4%, 5% year-over-year, $11.5 billion to $12 billion. So, we continue to see good health in that Space and Intel business, and again a lot of it's from classified and lot of it is based on the last five, six years of investments in IRAD, that have positioned us in some places that frankly where our classified customers are moving towards with disaggregated resilient responsive solutions. So Jason, hopefully that answered part of your question, let me stop there and see if there's anything else you wanted to clarify.

Jason Gursky
Analyst, Citigroup Global Markets, Inc.

Q

No, that was great. I appreciate the color. That's it for me.

William M. Brown
Chairman, President & Chief Executive Officer, Harris Corp.

A

Thank you.

Operator: Thank you. Our next question comes from Noah Poponak of Goldman Sachs. Your line is now open.

Noah Poponak
Analyst, Goldman Sachs & Co. LLC

Q

Hey good morning, everyone.

William M. Brown
Chairman, President & Chief Executive Officer, Harris Corp.

A

Hey, Noah.

Noah Poponak
Analyst, Goldman Sachs & Co. LLC

Q

Can you remind me, so the environmental programs that are declining in Space and Intel, what quarter did those start going against you?

William M. Brown
Chairman, President & Chief Executive Officer, Harris Corp.

A

They started in Q1. So, we saw in Q1, the environmental business rolled down about 10% to 15%...

Rahul Ghai
Chief Financial Officer & Senior Vice President, Harris Corp.

A

About 15%.

William M. Brown
Chairman, President & Chief Executive Officer, Harris Corp.

A

About 15% and we see that about the same for the balance of the year.

Rahul Ghai
Chief Financial Officer & Senior Vice President, Harris Corp.

A

It's a little bit worse – about the same for Q2, and then maybe, a little bit worse in the back half of the year.

William M. Brown
Chairman, President & Chief Executive Officer, Harris Corp.

A

A lot of it, Noah, is the roll off of the GOES-R program which was last year, plus we've got a couple of sensors that we're developing for these NASA/NOAA's satellites, they call them JPSS, the Joint Polar Satellite System and then the 3 and 4 I think, they call Polar Follow-On, so they changed the name on it, but we've got some sensors on that. And there's been some funding pressure around the Polar Follow-On missions, which is JPSS-3 and JPSS-4.

Noah Poponak
Analyst, Goldman Sachs & Co. LLC

Q

So, GOES-R was declining in the back half of last year?

Rahul Ghai
Chief Financial Officer & Senior Vice President, Harris Corp.

A

GOES-R was kind of overall flat, Noah, 2016 to 2017 was kind of flat and then it declined substantially this year.

William M. Brown
Chairman, President & Chief Executive Officer, Harris Corp.

A

Yeah. It started to trail off a little bit in the back into fiscal 2017 because remember this satellite launched in November of 2016, calendar 2016.

Noah Poponak
Analyst, Goldman Sachs & Co. LLC

Q

All right. I guess, what I'm wondering is just the segment grew 3% in the quarter despite the environmental programs, headwinds, and the guidance for the year is flat to up 1%. So you have to be basically exactly flat the rest of the year to be in that range. So, you'd have to decel from the first quarter even though you grew 3% in the first quarter with the headwinds and even though the year-over-year comparisons in the back half of the year are much easier.

So, does that headwind accelerate through the year, or is there something else that goes against you later in the year that didn't in the quarter?

Rahul Ghai
Chief Financial Officer & Senior Vice President, Harris Corp.

A

No, I think – Noah, I think you got most of it. So, the headwind does accelerate a little bit on the environmental side; classified, we're expecting about 5% for the full year, it grew about 8% in Q1, so not as strong of a growth on the classified side on the back half of the year.

Noah Poponak
Analyst, Goldman Sachs & Co. LLC

Q

Okay. And then, similar question on the margin in the segment, I mean, you're sort of 100 basis points above the high end of the range in the first quarter, you would have to be much lower the rest of the year to get into certainly the low end of the range. What changes in the margin through the year in Space and Intel?

Rahul Ghai
Chief Financial Officer & Senior Vice President, Harris Corp.

A

Yeah, and margins typically fluctuate quarter-to-quarter depending on the mix. And we have some award fee true-ups on a couple of programs and that helped margins in Q1. Having said that, the margins were strong in the first quarter, and you really feel good about the full-year guidance for the segment, on margins.

Noah Poponak
Analyst, Goldman Sachs & Co. LLC

Q

Okay. Okay, great. So then, one other question, I guess, in the legacy Harris domestic tactical radio business, I had sort of always thought of the model as the legacy base business, which I estimated and maybe even said, made it to about $300 million last year. And then, we were sort of layering on all the new program wins and just sort of assuming, and it felt like even hoping, that the $300 million legacy base before new programs business could just hang on to $300 million, because there was some reason to believe there could be cannibalization of that as new programs came online.

And then, when you announced this Navy win about a month ago, it sort of made one come to the realization that actually about a $50 million piece of that $300 million, if the IDIQ conversion holds, now is itself tripling. And so one, I guess, is that true of that maybe piece of that business? And then two, in the remainder of that $300 million, is there anything that is going to shrink considerably over the next one, two, three years, or is there anything else in there that has the potential to grow in size as much as that Navy business just did for you?

William M. Brown
Chairman, President & Chief Executive Officer, Harris Corp.

A

Yeah. I think you're about right on the $300 million in terms of base funding, and that has been relatively stable over the last couple of years. It depends on where you characterize some of the readiness investment we saw in Q1, of about $100 million in orders. So does that sort of go into base or is that an upsize [ph] or is it (46:09) mix of the two, but you're largely about right. The Navy IDIQ award is very encouraging coming in, and it was sole sourced to Harris to replace something that expires, so it was fully exhausted the prior contract vehicle. And what I think it reflects is, if you look in the FYDP and you'll see out a couple of years, the Marine Corps. is going to start to modernize, it happens in, I think it's in the fiscal 2019, fiscal 2020 timeframe, and it starts to grow quite large, and I think the IDIQ vehicle is sized such that, that it compensates for, it allows for that modernization of Marine Corps. to happen. So that'll be beyond our fiscal 2018, will start in 2019 and 2020. That I think, Noah, is actually encouraging for us overall, for where we see the business growing to beyond fiscal 2018.

Noah Poponak
Analyst, Goldman Sachs & Co. LLC

Q

Yeah. So in the remaining $250 million of the $300 million base ex that Navy piece, anything else in there we should be watching out for that – as a contract renewal coming up, or that has some meaningful potential to grow a lot going forward?

William M. Brown
Chairman, President & Chief Executive Officer, Harris Corp.

A

No, nothing to point to, no. It's going to be relatively stable, it's going to be resets and spares and repairs and things that we typically do. There's a number of 117Gs in the inventory, there's 152As, there's SINCGARS radios that have some flow-through, it's not big, but flow-through there. There are going to be some investment over the next couple of years in terms of this crypto-mod upgrade. They won't replace all the radios and DoD inventory by the NSA – the deadline, which I think is in 2021 is the timeframe. So there are going to have to be some investment to upgrade the cryptography on the legacy radios that are sitting in there. So there's really nothing specifically to point to, Noah, and we'll talk more about that as we see it over time, but we see it's relatively stable.

Noah Poponak
Analyst, Goldman Sachs & Co. LLC

Q

Got it. Okay. Thank you.

William M. Brown
Chairman, President & Chief Executive Officer, Harris Corp.

A

You bet, Noah.

Operator: Thank you. Our next question comes from Sheila Kahyaoglu of Jefferies. Your line is now open.

Sheila Kahyaoglu
Analyst, Jefferies LLC

Q

Hi. Good morning. Thank you for taking my question.

William M. Brown
Chairman, President & Chief Executive Officer, Harris Corp.
A

Good morning.

Sheila Kahyaoglu
Analyst, Jefferies LLC
Q

Just on ES, if I could maybe follow up. That's also trending above the high-end of your segment guidance. What's sort of driving the balance for the rest of the year?

Rahul Ghai
Chief Financial Officer & Senior Vice President, Harris Corp.
A

Sorry, Sheila. Could you -

William M. Brown
Chairman, President & Chief Executive Officer, Harris Corp.
A

Were you talking, Sheila, on ES, if I heard it right?

Sheila Kahyaoglu
Analyst, Jefferies LLC
Q

Can you hear me better?

Rahul Ghai
Chief Financial Officer & Senior Vice President, Harris Corp.
A

Yeah.

William M. Brown
Chairman, President & Chief Executive Officer, Harris Corp.
A

Okay. You're asking Electronic Systems, I didn't quite get the front...

[07K075-E Sheila Kahyaoglu]>: Yeah, exactly. Just the margins trending better in the quarter, and what changes throughout the year?

Rahul Ghai
Chief Financial Officer & Senior Vice President, Harris Corp.
A

Yeah. So Sheila, again, the margins kind of – same thing on Space, the margins do fluctuate quarter-to-quarter, and that's why we don't provide kind of quarterly guidance on margins, but the fact was that we are – mix was a little bit more skewed towards fixed price programs, that helps, and also there was some close out on fixed price programs in the quarter, that helped margins as well. So, again, really good start to the year. And we feel good about where our guidance happens to be for full year.

Sheila Kahyaoglu
Analyst, Jefferies LLC
Q

Thank you. And then, just the F-35 program, how do we think about, if you could size it for us, or how do we think about the build rates and potential content wins, and what that means for the Harris growth rate for that program for 2018?

William M. Brown
Chairman, President & Chief Executive Officer, Harris Corp.

A

Yeah, look, we have good content on F-35. It's just over $2 million per ship set. We provide the common components, avionic components, backplane, liquid cooled racks, things like that, we also provide the antennas for the – they call the MADL, the multifunction data link. And then we also provide release systems as well. So the carriage and release, and we talked about an award we received in Q1 associated with F-35 release systems.

So overall, it's just over $2 million. We're on I think LRIP 10 on the release systems and LRIP 12 on the common components and the avionic systems. There's been a lot of conversation around block buys, we're working with our partners on that as to how they might flow in and get shaped over the course of the year. But we've also won some recent content. We won the Aircraft Memory System, which was a big and important win for us. We won the Panoramic Cockpit Display Electronic Unit, so the head-down display electronic units and that adds, call it, 5% to 10% roughly to the content per ship set and that will flow in over time.

So, we're performing very, very well, we have very high delivery rates, we've been working strong with our partners in taking cost out and driving improvements in reliability. We've invested in open system technologies. So we have an opportunity to compete for new mission systems, open systems over time and we're very competitive in that space. So, overall we think F-35 is going to be a good – has been and will continue to be a good story for us, Sheila.

Sheila Kahyaoglu
Analyst, Jefferies LLC

Q

Thank you. And then Bill, just the last one, you mentioned the Leader Radio program.

William M. Brown
Chairman, President & Chief Executive Officer, Harris Corp.

A

Yes.

Sheila Kahyaoglu
Analyst, Jefferies LLC

Q

If you could just provide a RFP timeline for that and just the sizing of that opportunity?

William M. Brown
Chairman, President & Chief Executive Officer, Harris Corp.

A

Sure. The RFP is out, the proposals are in. We expect an award sometime in early calendar 2018, it'll be build off of the existing Rifleman Radio IDIQ. The IDIQ was contemplated originally at $3.9 billion to include the possibility of a two-channel radio. That in fact is happening. We'll provide some small number of radios for testing in the early part of next year and that will ramp for us in fiscal 2019.

Operator: Thank you. And our final question comes from Robert Stallard of Vertical Research. Your line is now open.

Robert Stallard
Analyst, Vertical Research Partners LLC

Q

Thanks so much. Good morning.

William M. Brown
Chairman, President & Chief Executive Officer, Harris Corp.

A

Hey, good morning, Rob.

Robert Stallard
Analyst, Vertical Research Partners LLC

Q

Bill, we've covered a lot already. But one thing I thought was worth asking and you highlighted a very strong book-to-bill in Q1. I was wondering if you saw anything pull forward into the first quarter and whether the looming continuing resolution might have had any impacts on DoD orders in the quarter?

William M. Brown
Chairman, President & Chief Executive Officer, Harris Corp.

A

Yeah, not particularly, obviously Australia was an important component to that in the CS business, but even excluding that we had very good book-to-bill internationally in DoD. We actually saw a couple of things that moved out of September and October that we had hoped would happen in September, but we're on good track for them in Q2. And again similar good trajectory right now in Electronic Systems as well as Space and Intel. So nothing in particular that I would characterize as a pull forward because of the end of the fiscal year. As you know, what you normally see is that at the end of a fiscal year September, that tends to be our big booking month and it was again, but nothing unusual that we saw this year relative to the prior years.

Robert Stallard
Analyst, Vertical Research Partners LLC

Q

Okay.

William M. Brown
Chairman, President & Chief Executive Officer, Harris Corp.

A

Sorry, Rob, just to put a finer point on that, I mean so overall our book-to-bill was 1.6 times and even if you exclude Australia, it was 1.45 times. And compare that to last year, which was about 1.2 times. So even excluding Australia, the book-to-bill was really good.

Rahul Ghai
Chief Financial Officer & Senior Vice President, Harris Corp.

A

Yeah. Yeah.

Robert Stallard
Analyst, Vertical Research Partners LLC

Q

Yeah. I just have a follow-up to ask, I mean it's tough to nail this down annually and link quarterly, but you're still confident that we'll have a book-to-bill of over 1 times for the year?

William M. Brown
Chairman, President & Chief Executive Officer, Harris Corp.

A

Yes. We believe it'll be more than 1 times. In fact, it should be, I would say, substantially better because of Australia in the CS segment, we're much more confident there on a more substantial book-to-bill for the year.

Robert Stallard
Analyst, Vertical Research Partners LLC

Q

That's great. Thanks so much.

William M. Brown
Chairman, President & Chief Executive Officer, Harris Corp.

A

Sure.

William M. Brown
Chairman, President & Chief Executive Officer, Harris Corp.

Okay. Well, thank you, everybody. Before we end the call, I'd like to make sure we thank the Harris team for delivering a strong quarter despite the impact of Hurricane Irma to our Florida operations, which as many know has more than 6,000 employees. The storm passed early on a Monday morning. We partially restarted the operations on Tuesday and we were back nearly 100% by Wednesday and it's remarkable, it was within 48 hours. And I'm very, very pleased and proud of the team's performance.

I'm also proud that our customers experienced no significant disruption of service, including the FAA which relies on our Network Operation Center here in Florida to monitor air traffic across North American Airspace as well as the first responders that we support throughout the State of Florida. So we responded very, very well and I'm very pleased and proud of the team.

Overall, we had a good start to the year, we're confident in both our fiscal 2018 and medium-term outlook. We're in an environment where defense budgets are coming up, the technology solutions we provide are aligned with the mission priorities of our customers and very importantly, we have a dedicated team, that's geared towards exceeding customer expectations and delivering shareholder value.

So thank you everybody for joining the call and we'll speak again next quarter.

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