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HRS - Q1 2017 Harris Corp Earnings Call

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OVERVIEW:

Co. reported 1Q17 non-GAAP EPS of $1.39. Expects FY17 total Co. revenue to be $7.1-7.3b and GAAP EPS to be $5.53-5.73.

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CORPORATE PARTICIPANTS

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Bill Brown *Harris Corporation - Chairman and CEO*

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Greg Conrad *Jefferies & Company - Analyst*

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Robert Stallard *Vertical Research - Analyst*

Gautam Khanna *Cowen and Company - Analyst*

Noah Poponak *Goldman Sachs - Analyst*

PRESENTATION

Operator

Welcome to Harris Corporation's first quarter 2017 earnings 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 would now like to turn the call over to Ms. Pamela Padgett, Vice President of Investor Relations. Ma'am, you may begin.

Pamela Padgett - *Harris Corporation - VP of IR*

Thank you. Hi, good morning everyone, and welcome to our first-quarter FY17 earnings call. I'm Pamela Padgett, and on the call today is Bill Brown, Chairman and CEO; and Rahul Ghai, Senior Vice President and CFO.

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

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

Bill Brown - *Harris Corporation - Chairman and CEO*

Thank you Pam, and good morning everyone. Harris began FY17 with a good start out of the gate, and we're executing well against our key strategic priorities. I'll begin with a quick update about how we're delivering on them.

As part of an ongoing initiative to optimize our business portfolio, we announced earlier this morning a definitive agreement to sell the CapRock commercial business for $425 million, and plan to use the proceeds to pay down debt and repurchase shares. Portfolio shaping supports our strategy to invest in businesses where Harris can provide technology differentiation. We'll continue to review our portfolio and objectively access which businesses are a strategic fit, and which businesses have better value under a different ownership structure.

We also remain committed to smart and balanced capital deployment. In the first quarter, we used $100 million in cash to repurchase shares, and we increased the dividend 6%, our 15th consecutive annual increase. We also repaid $33 million in term debt, and in early October retired a $250 million bond that was due, making further progress towards our three-year debt-reduction goal of $2 billion, and we're about halfway there.

We remain laser-focused on Exelis integration and capturing synergies and related accretion, and through Q1, we're tracking well towards capturing $50 million of additional end-year savings, and achieving our target of $140 million to $150 million in run-rate savings as we exit FY17. While all integration projects are complete or well underway, we'll continue to find ways to lower costs and drive productivity as part of our normal operational excellence agenda.

Finally, investing in R&D and new product development to grow core franchises, and expanding to close adjacencies has been an important part of our strategy. In the first quarter, R&D spending was up 7%, and over 4% of revenue. For the year, we still expect to spend at about 4% of revenue, similar to FY16, and at a level well above our peers.

Turning now to Q1 results, non-GAAP earnings per share was $1.39, up 6% on a 2% organic revenue decline. Despite the revenue headwind and higher R&D spending in the quarter, operating margin increased 50 basis points as a result of higher synergies, productivity savings, and pension income. Earnings per share also benefited from a lower tax rate in the first quarter.

Revenue reflected continued growth in space and intel, up 4%, and electronic systems up 2%, while communication systems was down 5% and critical networks was down 7%. Orders were particularly strong, with total Company booked to bill of 1.17, and funded backlog up 6% over the prior quarter. Booked to bill for each segment was above 1. Within communication systems, we saw strong recovery in our legacy tactical business, where booked to bill was 1.22. Healthy bookings, plus several opportunities that slipped from the back half of FY16, drove backlog up 16% sequentially to $467 million, and higher in both DoD and international.

Q1 revenue in legacy tactical was also encouraging at down 1%, with DoD revenue up 4%, and international down 4%. Within DoD, higher first-quarter revenue was primarily related to achieving important milestones early in the year for MMVR and Milos. We received a limited rate production authorization on MMVR, which is our mid-tier networking radio; and formal NSA certification for running the Milos satellite wave form on existing Falcon 3 117 Gs, which triggered initial fielding of Milos capability.

Also in the quarter, the Army contracted Harris to develop the narrow-band mode for the Soldier Radio Waveform, or SRW, a requirement for all Army modernization radios -- the Manpack, the Rifleman, the MMVR, and the future SANR, or small airborne networking radio. This contract demonstrates Harris leadership and expertise in adapting complex waveforms to meet the changing requirements of the Army's tactical network.

In legacy international, revenue trended favorably against our full-year guidance, and was higher in Europe, Central and Latin America or CALA, and Asia Pacific, but was offset as anticipated by lower revenue in Central Asia and the Middle East Africa regions.

You'll recall that Europe was strong in FY16, driven primarily by eastern European countries, and that trend continued in Q1, with encouraging signs for the balance of the year. The CALA region is benefiting from a country's modernization on next-gen radios, and a new $90 million contract win from US Southern Command, supporting countered [Icodic] missions in Latin America.

In Asia PAC, we are supplying HF and multi-band radios to support maritime capability in a southeast Asian country as part of an ongoing trend of the US bolstering partnering capabilities in the region, and a significant opportunity remains on the horizon in Australia.

Overall, regional trends of strength and headwinds are tracking about as we laid out in our 3Q and 4Q earnings calls, and while still early in the year, represents a good start towards achieving our full-year guidance.

Turning to space and intel, we had another quarter of excellent wins from customers in the intelligence community, which continues to be a solid growth area for the Company. In the quarter, Harris won a $25 million initial contract to develop a multi-mission small satellite for a classified customer, our second government win in this area.

Small sats are emerging as a low-cost solution to a rapidly changing threat environment, offering a shorter development cycle, and launched at a fraction of the cost and lead time of a large exquisite satellite. Our offering is this growing niche is powerful, combining a portfolio of advanced sensors, software-defined radio technology to support on-orbit mission changes, and Harris agility to quickly innovate as threats evolve.

We also continue to build on our franchise in space superiority. Following the close of the quarter, Harris was selected for $53 million in follow-on work to provide counter-communication capabilities that detect adversary interference, and take action to protect our space assets. This new win will bring contracts to date for this mission to about $200 million.

Outside the intelligence community, we received a $90 million follow-on contract to provide navigation payloads for GPS3 space vehicles 9 and 10. We're already under contract to deliver payloads for SV1 through 8, and we're investing to develop a fully digital solution for 11 through 32.

Turning to electronic systems, Q1 marked the third consecutive quarter of strong bookings for electronic warfare, winning modernizations on legacy platforms where we have strong incumbency positions. As the EW capability gap between the US and peer countries has narrowed, modernizations on deployed fleets have become a higher priority. Wins included a $22 million contract for the B-1B, and a three-year, $55 million contract to redesign the electronic warfare system for the B-52. B-52 wins over the last two years now stand at about $200 million, and we continue to see strong future opportunities on fleets with long modernization tails.

In critical networks, Harris expanded its reach into a new market by leveraging a strong and long, successful history with the FAA for designing and maintaining highly secure communication networks. Following the close of the quarter, Harris was awarded a 14-year, $700 million ceiling IDIQ from the state of Florida to provide a statewide secure communications network. This network, called My Florida Net 2, will have about 4,000 sites connecting public safety, law enforcement, and other state and local government agencies.

With that, let me now turn the call over to Rahul for more financial detail and guidance. Rahul?

Rahul Ghai - *Harris Corporation - SVP and CFO*

Thank you, Bill, and good morning everyone. Just to remind you, discussions today are on a non-GAAP basis, and supplements GAAP results in our other quarterly earnings material.

Turning now to segment detail on slide 4, Communication Systems segment revenue was $431 million, and down 5% compared to prior year. Tactical communications was down 6%, primarily as a result of lower international SINCGARS sales. Public safety was down 1%. Operating income was $119 million, compared with $138 million in the prior year, driven by lower volume and mix. On slide 10, we have again included historical information for legacy tactical, orders, revenue, and backlog.

Space and intelligence systems on slide 5Revenue was $453 million, and up 4% compared to prior year. This was driven by higher revenue from intelligence community customers, and from Radiation Budget Instrument Program, called RBI, to provide sensors for monitoring climate change and global warming on NASA's Joint Polar Satellite System. Operating income was $80 million, compared with $68 million in the prior year, driven by continued strong program performance and high retention income.

Electronic systems on slide 6. Revenue was $361 million, and up 2% on an organic basis compared to prior year, excluding $19 million of revenue from aerostructures business that was divested in the fourth quarter of FY16. Higher revenue from initial ramp of recently awarded integrated battle management systems in Middle East, and from electronic warfare solutions, was partially offset by lower wireless product sales.

Operating income was $74 million, compared with $69 million in the prior year. In addition to the electronic warfare contracts that Bill mentioned, Harris received $35 million in follow-on contracts for the F-35 program.

Critical networks on slide 7. Revenue was $527 million, and down 7% compared to prior year. Higher revenue from FAA's next-gen modernization program was more than offset by lower revenue in IT services, down $13 million, and in CapRock's commercial business, down $25 million.

IT services revenue was in line with expectations of it stabilizing in the $225 million to $250 million first-quarter range. CapRock Commercial is now at approximately $75 million per quarter. Operating income was $66 million, compared with $63 million in the prior year.

On top of what was already mentioned, Harris was awarded a five-year, $125 million single-award IDIQ for IT services from a classified customer. This extends a 25-year relationship, and reflects a business development focus in the intelligence community.

Moving to slides 8 and 9, FY17 guidance remains unchanged, with GAAP EPS guidance in a range of [$1.553 to $1.573], (see slide 8 sic $5.53 - $5.73) and non-GAAP EPS in a range of [$1.57 to $1.59] (see slide 8 sic $5.70 - $5.90). As previously communicated, EPS guidance reflects $150 million in share repurchases for the year.

Total Company revenue guidance is unchanged, in the range of $7.11 billion to $7.33 billion, down 1% to 4% on an organic basis, excluding revenue from aerostructures divestiture. (inaudible - accent) segment and other details outlined with slides also remain unchanged, including generating an expected $800 million in free cash flow for the full year.

Although the first quarter tax rate was 27.5%, we still expect a full-year tax rate of 31%. Our expected 31% rate reflected adoption of a new accounting standard for stock compensation, and the benefit occurred primarily in the first quarter. The remaining three quarters are expected to average 32% rating quarter to quarter, depending on specific tax timing differences. We will update FY17 guidance once CapRock transaction closes.

Now I will hand it back to Bill for a few closing comments.

Bill Brown *- Harris Corporation - Chairman and CEO*

Okay, well thank you, Rahul. Overall we had a good start to the year, delivering solid financial results and making excellent progress on our key strategic priorities. We're maintaining guidance for the year, and we anticipate that the continuing resolution will extend through the balance of the calendar year, and constrain spending as it typically does until a budget is passed.

We'll continue to enhance shareholder value by optimizing our business portfolio, de-leveraging, re-investing to drive future growth, and allocating capital in a shareholder-friendly way. With that, I'd like to ask the operator to open the line for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Seth Seifman, JPMorgan. Thanks very much, and morning everyone.

Seth Seifman *- JPMorgan - Analyst*

Thanks very much, and good morning, everyone. I'm not sure how much you can comment on it, but there have been reports in the press about potentially divesting other portions of the critical networks business. I wondered, can you talk a little bit more about your vision for that business, specifically, in the future?

Bill Brown - *Harris Corporation - Chairman and CEO*

Well, Seth, thank you for the question. I'm not going to comment on any potential plans. We simply don't do that. I think we feel good about the transaction we're announcing today on selling the CapRock commercial business.

We've got a pretty strong track record here of looking pretty objectively at the businesses that we're in, and assessing which fit and which do not. I take you back to the broadcast business in commercial health care and aerostructures, and now the commercial CapRock business, and we continue to look pretty objectively at the portfolio that we have, and assess what fits and what does not.

I would say that I've been pretty consistent in commenting that we want to be in businesses where technology can differentiate our offering in the market place. That's very important to us. Of course, we look at strategic fit and performance of the business, but that is certainly the bar and the milestone that we're tracking there. We'll say more as time goes on, but nothing more to report today.

Seth Seifman - *JPMorgan - Analyst*

Okay, great. Thanks, and then just as a quick follow-up, more in the model in communications systems. It was a nice quarter for the tactical radios. The margin overall for the segment was a little below your guidance for the year. Is that reflecting R&D or mix? What's going to change through the course of the year to bring that margin up?

Bill Brown - *Harris Corporation - Chairman and CEO*

Yes, it reflects both. It's down year over year. It's flat sequentially. Part of it is volume. The tactical comms business -- not just rated, but tactical comms -- it's a bit less favorable mix. We had slightly more sustainment services business in Q1; a little more front-end-loaded R&D, which should mitigate a little bit over the course of the year. Of course these things move quarter to quarter, but over the balance of the year we'll expect better mix. We do expect to still achieve the guidance margins for the year of about 30%.

Seth Seifman - *JPMorgan - Analyst*

Great. Thank you very much.

Bill Brown - *Harris Corporation - Chairman and CEO*

Sure.

Operator

Greg Conrad, Jefferies.

Greg Conrad - *Jefferies & Company - Analyst*

Good morning.

Bill Brown - *Harris Corporation - Chairman and CEO*

Good morning.

Greg Conrad - *Jefferies & Company - Analyst*

I'm hoping to go back to CapRock. I was just wondering if you expect that to be accretive or dilutive, and then what could be the cash proceeds from that sale?

Bill Brown - *Harris Corporation - Chairman and CEO*

We're selling it for $425 million, so cash will be a little bit below that, but probably over $400 million. We're going to use it for both debt pay-down and share repurchases -- probably a little bit more than half on debt, a little less than half on share buy-back. On an annual basis, we would expect it to be about $0.04 dilutive.

Greg Conrad - *Jefferies & Company - Analyst*

Thank you. Then it seems like you've had a couple good quarters in terms of bookings for electronic warfare. I was hoping you could maybe size that business, and what we can expect for the outlook going forward?

Bill Brown - *Harris Corporation - Chairman and CEO*

Yes, we feel really good about the performance in electronic warfare -- had really strong bookings really throughout last year. Orders doubled, backlog grew quite a bit, booked-to-bill was stronger than one. Coming out of the first quarter, with good revenue growth but also good strong bookings, we feel very good about that business.

Again, we've got very strong positions in a number of legacy platforms that require modernization upgrades. There's new threats on the horizon. Our military has talked quite a bit about that, and our aircraft need to be upgraded. We certainly have a great position on F-18. We're on international F-16s in large aircraft like B-1B, C-130, and the B-52 has been an important driver of our bookings and future growth.

We feel very good about where we're at today on electronic warfare. We continue to invest in smaller size-weighted power platforms. We've got a good position on the classified side. Over time, when you pair up Harris's front-end phased array technology with electronic warfare capabilities from Exelis in the back end, that capability's pretty special. We feel good about where we stand today in electronic warfare.

Greg Conrad - *Jefferies & Company - Analyst*

Is that about half of electronic systems, is that a fair estimate?

Bill Brown - *Harris Corporation - Chairman and CEO*

A little less than that. Yes, it's about $500 million, $550 million, in that range.

Greg Conrad - *Jefferies & Company - Analyst*

Thank you.

Operator

Pete Skibitski, Drexel Hamilton

Peter Skibitski - *Drexel Hamilton - Analyst*

Hi, good morning guys. Bill, did first-quarter sales come in a little stronger than you expected, just because of the CR ongoing? Do you think you'll feel the impact more so on the second quarter, because that's the first fiscal quarter of the government's year?

Bill Brown - *Harris Corporation - Chairman and CEO*

I'm sorry, Pete, I didn't -- the phone is breaking up, but I didn't hear the front end of it. Something about something coming in stronger. Can you say that one more time?

Peter Skibitski - *Drexel Hamilton - Analyst*

Yes, sorry. Just wondering if your first-quarter sales came in a little stronger than you expected because of the CR, or do you think the CR will impact more so your second quarter because of the -- that's the first fiscal quarter of the government's year?

Bill Brown - *Harris Corporation - Chairman and CEO*

What we see going back a number of years is we've been operating under a CR at the beginning of the government fiscal year. We tend to see some end-of-year money getting spent, bookings and revenue. That tends to slow down a little bit in the second quarter. We would expect the normal friction we would typically see in our Q2 as we typically have seen in a CR, under a CR, and improving in the back half of the year.

Peter Skibitski - *Drexel Hamilton - Analyst*

Okay, great. Thanks, guys.

Bill Brown - *Harris Corporation - Chairman and CEO*

You bet, Pete.

Operator

Robert Stallard, Vertical Research.

Robert Stallard - *Vertical Research - Analyst*

Thanks very much. Good morning.

Bill Brown - *Harris Corporation - Chairman and CEO*

Good morning, Rob.

Robert Stallard - *Vertical Research - Analyst*

Bill, you highlighted the very strong booked-to-bill in the quarter. I was wondering of the orders you have taken in the last three month, whether the lead time on this is any different from what you normally expect? What we're obviously looking for is when does this convert into revenues?

Bill Brown - *Harris Corporation - Chairman and CEO*

The bookings we saw, which were pretty good on the tactical side, are relatively quick-turn orders That's a short-cycle business, so the majority of that will turn in the year, and that's positive for us.

But it depends on the business. There are some parts of the Company that are longer cycle. The very long -- the big order we got in the state of Florida is going to happen over the next decade, effectively. Some of the EW orders are going to be over the next three, four years, so it depends on the business. Our longer-cycle businesses tend to be in the ES segment and space and intel segment, and of course the shorter-cycle orders are going to come in our tactical or CS side.

Robert Stallard - *Vertical Research - Analyst*

Okay. Then as a second question, you've mentioned in the past that the Middle East, Central Asia, and Africa have been softer markets for you on the radio side recently. Has there been any sign of that stabilizing as yet?

Bill Brown - *Harris Corporation - Chairman and CEO*

Well, we're not seeing anything better today than we did over the last three to six months. It's the same factor that we've been talking about that continued to impact that region. Certainly low oil prices, which seem to be going down even further, are causing budgetary pressures. We know the conflicts in Syria, Iraq, Yemen, is driving some instability. Some of the funding is going more towards munitions than communications.

I would say that we've seen some opportunities firm up in a couple of areas, like Jordan and the UAE. In Jordan, we booked an order here in the first quarter, and we see more opportunities on the horizon. Saudi continues at a relatively low level. 2016 came down from 2015, but we don't see another big step-down in 2017. Right now it's running at a relatively low level as we see it. There's some pressure in Iraq just because of the strife in the country, but the opportunities we see on the horizon in Iraq are very sizable. It's probably the biggest opportunity overall in our long-term pipeline.

It's a mixed bag within the Middle East, but not much of the story has changed over the last three to six months. Some of the slips that happened from 2016 into 2017 we have started to book, and we'll continue to do that in Q2 and Q3. Thank you, Rob.

Robert Stallard - *Vertical Research - Analyst*

That's great. Very helpful, thank you.

Operator

Gautam Khanna, Cowen and Company.

Gautam Khanna - *Cowen and Company - Analyst*

Hi, good morning guys.

Bill Brown - *Harris Corporation - Chairman and CEO*

Good morning.

Gautam Khanna - *Cowen and Company - Analyst*

I had a couple questions. First, last quarter if I recall, Bill, you mentioned there was $65 million to $70 million of shipments that slipped into the first fiscal quarter. I was wondering, did you in fact catch those all up? Were those booked in the current -- in the September quarter, or were those in the backlog as of June 30?

Bill Brown - *Harris Corporation - Chairman and CEO*

Yes, I think we said it was around $60 million worth of orders did not happen in Q4. About half was -- a little more than half was international, and that did slip into the year into Q1. It was like $30 million, $35 million, in that range. Yes, we pick those up in Q1, effectively as part of our release.

The other part was the DoD side, and that was just general slowness and some friction, cautious buying behavior on the part of some of the Florida acquisition folks. That was not necessarily a slip, but certainly the international piece that moved into Q1 did happen.

Gautam Khanna - *Cowen and Company - Analyst*

That was a book and ship in the September quarter?

Bill Brown - *Harris Corporation - Chairman and CEO*

Largely, yes.

Gautam Khanna - *Cowen and Company - Analyst*

Okay. Could you talk a little bit about the tax basis of your IT service business? Could you size of for us? I believe it's about $1.03 billion, but I wanted to get your sense for that -- also, what the tax leakage will be with the CapRock sale? How much will you actually net in terms of proceeds?

Bill Brown - *Harris Corporation - Chairman and CEO*

Yes, I'm not going to comment on the tax basis for services, but service is around a $1 billion business, and there's no tax leakage on the CapRock transaction.

Gautam Khanna - *Cowen and Company - Analyst*

Okay. Also, previously you've updated us on some of the major campaigns, like the JTRS Manpack radio timing. I wanted to see A, when is that going to happen? Do you think it will still be two awardees? Relatedly, if you could talk about when Australia might actually book some orders -- is that still in fiscal Q4 this year? Maybe any of the other sizable campaigns that we should be tracking?

Bill Brown - *Harris Corporation - Chairman and CEO*

Yes, let me start with Australia. It's still a big opportunity on the horizon. It's on the order of in total about $600 million, or a little less than that. But they decided to split into two pieces, as I mentioned on the last call. We still expect about half will book towards the back end of our fiscal year, the other some time into 2018 or beyond. We feel very good about the progress there and our position on that particular opportunity.

On the Manpack, it continues to progress. We are one of three awardees. It's a very sizable contract. We completed the qualification test. The customer testing should happen early in FY17, so in the next three or four months. Then it will go into a delivery order procurement will be made by -- a decision will be made by August, I believe, of next year, with deliveries off of that starting about a year from now, and then continuing into early calendar 2018. That has not moved out in terms of the delivery time frame on the back end.

On the other one, which is important is Rifleman. We're one of two vendors, us and Talas. You recall, it was a $3.9 billion IDIQ. We've gotten through qual-test and customer test. It was for a single-channel radio, but you recall they left a big part of the overall award value with an opportunity for a two-channel radio. It does sound like the Army is looking to perhaps accelerate the purchase of a two-channel radio. They saw the opportunity that the radio we have with SOCOM, which is a single-vendor award that we have as Harris Corporation. They saw the radio. There's a possibility they will accelerate the purchase of a two-channel radio, which I think will be relatively good news for Harris, since we're well-positioned on that particular opportunity.

You saw in Q1, or at least I mention in Q1, that we got a milestone C approval on the mid-tier radio, with half of the opportunity recognized in Q1. The other half will come sometime later in our FY17. Overall, I think good progress.

Milos, we are very pleased with receiving NSA cert, and to see initial fielding of that capability. Keep in mind, there's 30,000 117 Gs in the field that have the possibility of being upgraded with the Milos waveform. As that happens, since the development is all behind us and it's a software load, it comes down to us at a relatively high margin, all of which I think is good progress in the quarter, Gautam.

The last one I would mention is on SOCOM, I think the very important one. That's a two-channel radio. That continues to progress. We're investing in it, and we still see that on track for deliveries about a year from now.

Gautam Khanna - *Cowen and Company - Analyst*

Okay, thank you very much. I'll get back in the queue.

Bill Brown - *Harris Corporation - Chairman and CEO*

You bet, sure.

Operator

Noah Poponak, Goldman Sachs.

Noah Poponak - *Goldman Sachs - Analyst*

Hi, morning everyone.

Bill Brown - *Harris Corporation - Chairman and CEO*

Hi, Noah, good morning.

Noah Poponak - *Goldman Sachs - Analyst*

Bill, so you've mentioned -- or you've gone through a lot of detail on a number of moving pieces into your potential future order flow. I wondered if you would just -- if you're able to tell us if you think the total Company booked-to-bill, and also specifically the legacy tactical radio booked-to-bill will be above 1 for the full-year FY17?

Bill Brown - *Harris Corporation - Chairman and CEO*

That's certainly the trajectory that we're on, and the hope that we have. Right now, we came out of the gates in Q1 very strong. I think we're pleased about that. We always hope for, as we expect growth in 2018 and beyond, we certainly hope for good positive bookings in this quarter, or this year, that will lead us into growth in 2018.

Noah Poponak - *Goldman Sachs - Analyst*

Okay. As a follow-up to the question on the Middle East contribution to the legacy tactical radio business, is it possible to quantify what the peak-to-trough has already been in that revenue stream, just so we can get a sense of how much lower that could go, or maybe if it's approaching a floor, just because enough of a decline has already happened?

Bill Brown - *Harris Corporation - Chairman and CEO*

Yes, I think we're probably down about 40% peak-to-trough at this point. From the way we see it today, the Middle East should maybe down slightly more again in 2017, but it depends on the timing of some opportunities in Iraq. Again, Jordan looks pretty good, UA looks pretty good. A couple of other things are progressing pretty well in the quarter and what we see in the balance of the year. The funding support from the US government still remains pretty robust. We don't see a big step-down in the Middle East, but that's where we see it today.

Noah Poponak - *Goldman Sachs - Analyst*

Okay, that's helpful. What is that run rating, then, as a percentage of your legacy tactical radio business after that 40% peak-to-trough?

Bill Brown - *Harris Corporation - Chairman and CEO*

Is about on the order of about 25%, 30% of the international business. International is about two-thirds of the total tactical, the legacy tactical. It will be a little bit less than that, of course.

Noah Poponak - *Goldman Sachs - Analyst*

Okay, great. What is SINCGARS down to at this point?

Bill Brown - *Harris Corporation - Chairman and CEO*

It's at a relatively low rate. It's mostly international business. There's still some sustainment work going on with the US military, but a lot of that business is international, and is experiencing some of the same challenges in our legacy tactical business. There's a lot of it being sold into the Middle East. As you know, we talked about a pretty good opportunity that has been sitting out on the horizon in Saudi Arabia. It's in the $40 million to $50 million range for SINCGARS. That still remains toward the back end of the year. That would be the next big opportunity on the horizon, but it's at a relatively low rate.

Noah Poponak - *Goldman Sachs - Analyst*

Great, and I'll sneak in one more. The $700 million Florida comm systems contract, how much of that will go into the backlog in the December quarter?

Rahul Ghai - *Harris Corporation - SVP and CFO*

It's relatively small. I think it's in tens of millions at this point, so it's going to be low for this quarter. It will come more as we roll this out. It will come in stages.

Bill Brown - *Harris Corporation - Chairman and CEO*

This is a very big important opportunity for us, because today we run the state law enforcement radio system in Florida. We've been doing that for 15 years, now through 10 hurricanes without a single outage, so we feel very good about that. That credibility, alongside of our reputation with the FAA, allowed us to beat a very large telco out of a pretty substantial contract, interconnecting a bunch of offices in the state of Florida. We feel very good about the position that we happen to be in here, and it's going to roll itself out over the next decade or so.

Noah Poponak - *Goldman Sachs - Analyst*

Okay, terrific. Thanks very much.

Bill Brown - *Harris Corporation - Chairman and CEO*

You bet, Noah.

Operator

Thank you, and we have time for a follow-up question from Gautam Khanna with Cowen and Company. Your line is now open.

Gautam Khanna - *Cowen and Company - Analyst*

Yes, thanks again. I just had a couple small questions here. One, what is the chair creep at this point, option creep?

Bill Brown - *Harris Corporation - Chairman and CEO*

I think it's about 1 million shares. Yes, it's about 1 million shares. With the buyback in Q1, we held our share count, I think Rahul, about flat.

Rahul Ghai - *Harris Corporation - SVP and CFO*

Yes, Gautam, our overall share count on the diluted share count is about flat. We ended Q4 at 125.3 million, and we ended Q1 at 125.5 million. That's where we are.

Gautam Khanna - *Cowen and Company - Analyst*

Okay, so you need approximately 100 million just to offset creep, just to be clear. Is that right?

Rahul Ghai - *Harris Corporation - SVP and CFO*

Yes.

Gautam Khanna - *Cowen and Company - Analyst*

Okay. Is there plans to -- you mentioned with the proceeds of CapRock you'll repay debt. What is the longer-term plan here? Is the plan to take advantage of the weakness in the stock? I wondered how flexible is your logic around buy-back versus debt re-pay?

Rahul Ghai - *Harris Corporation - SVP and CFO*

As Bill mentioned, our current plan is we'll use slightly more than half the proceeds to pay down debt, and slightly less than half for share buy-back. What we have to -- what we are balancing here, Gautam, is we have a high debt-to-EBITDA ratio, then we have commitments to our debt rating agency. We're balancing that, and we have an aggressive debt buy-back debt pay-down goal. That is the objective at this point.

Gautam Khanna - *Cowen and Company - Analyst*

Okay.

Pamela Padgett - *Harris Corporation - VP of IR*

Okay, operator.

Bill Brown - *Harris Corporation - Chairman and CEO*

No, go ahead, Gautam.

Gautam Khanna - *Cowen and Company - Analyst*

Okay. The other thing, I just wanted to make sure, maybe I missed it. Is there any way you can size the opportunity to upgrade the installed 117 G base with the Milos software capability?

Bill Brown - *Harris Corporation - Chairman and CEO*

Yes, we see that could be just north of $100 million.

Gautam Khanna - *Cowen and Company - Analyst*

$100 million in aggregate across all 30,000? Is that right?

Bill Brown - *Harris Corporation - Chairman and CEO*

It could be -- it will be more than that, yes. That's the total opportunity that we see as we sit here today.

Gautam Khanna - *Cowen and Company - Analyst*

Okay. Then Bill, just given all this, if you could put it together for us, what do you expect the booked-to-bill to be at tactical legacy RS this year?

Bill Brown - *Harris Corporation - Chairman and CEO*

Well, we expect it to be over 1. I think that was a comment I was trying to make earlier today, which is as we go forward into and think about FY18, we still see some important elements that will drive growth. We see good performance in our longer-cycle businesses, in space and intel and electronic systems. We came off of a back half of 2016 with good growth. We had good orders, we ended with higher backlog. We came out of Q1 with good growth, higher backlog, good orders. That will carry us into FY18.

As we go through this year and we look out into 2018, we still see strong Army monetization opportunities, SOCOM monetization opportunities. Australia will start to come into the picture. We still see good opportunities to grow that business in FY18. That would require us to have a pretty solid bookings through the year. We're early in the year; we had a great start.

Gautam Khanna - *Cowen and Company - Analyst*

Well above one -- I'm not trying to be annoying. I'm just asking because what you sized in the later part of this fiscal year could be fairly substantial contract awards. A $300 million award from Australia would move the needle, presumably. I'm just wondering is a 1.2 out of the question? Over 1 seems like a low bar at this point, so I'm just -- could you help us --?

Bill Brown - *Harris Corporation - Chairman and CEO*

It's also early in the year. You don't win a football game in the first quarter. We've got three more to go. I'll give you -- I'll continue to give you an update on the way we see the market, the environment, the opportunities we're chasing as we go through the year. I think as we've done pretty clearly over the last couple of years, we'll communicate as much as we can. Right now, we expect -- and our folks up in the tactical business expect -- that we'll have a good year and a booked-to-bill over one. I think at this point, that's all we're able to communicate.

Gautam Khanna - *Cowen and Company - Analyst*

Thanks a lot, guys. Good luck. You bet, Gautam. You bet.

Pamela Padgett - *Harris Corporation - VP of IR*

Operator, we will take one more question, please.

Operator

Carter Copeland, Barclays

Unidentified Participant - *- Analyst*

Good morning, guys. This is actually Ruben on for Carter.

Bill Brown - *Harris Corporation - Chairman and CEO*

Hi, Ruben.

Unidentified Participant - - *Analyst*

Hi. Bill, do you think you can speak to more specifically how much op profit and EBITDA you expect to be leaving with the CapRock business here? I wanted to try to get my head around some of the metrics of the deal? Thanks.

Bill Brown - *Harris Corporation - Chairman and CEO*

Sure. We expect revenue in that CapRock commercial business this year at about $300 million. We did about $75 million, and we were at a level run rate for the year, so about $300 million. It's a mid-single-digit ROS business, so call it 5% to 6%. It's got $35 million, $37 million just of D&A. That can help you with some of the metrics.

Unidentified Participant - - *Analyst*

Okay, great. Thanks.

Bill Brown - *Harris Corporation - Chairman and CEO*

You bet.

Pamela Padgett - *Harris Corporation - VP of IR*

All right, everyone, thank you so much for joining us this morning.

Operator

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