L3Harris Technologies (LHX)

Updated August 17th, 2019 by Prakash Kolli

Key Metrics

Current Price:	$211	**5 Year CAGR Estimate:**	5.3%	**Volatility Percentile:**	45.3%
Fair Value Price:	$154	**5 Year Growth Estimate:**	10.0 %	**Momentum Percentile:**	91.7%
% Fair Value:	137%	**5 Year Valuation Multiple Estimate:**	-6.0%	**Growth Percentile:**	91.9%
Dividend Yield:	1.3%	**5 Year Price Target**	$249	**Valuation Percentile:**	13.4%
Dividend Risk Score:	B	**Retirement Suitability Score:**	D	**Total Return Percentile:**	25.4%

Overview & Current Events

L3Harris Technologies (LHX) is the result of a merger between L3 Technologies and Harris Corporation completed on June 29, 2019 creating the sixth largest defense contractor. Shareholders of L3 Technologies received 1.30 shares of Harris Corporation for each of their own shares outstanding. The company reports four business segments including Integrated Mission Systems, (30% of revenue) Communication Systems (23% of revenue), Space and Airborne Systems (25% of revenue), and Aviation Systems (23% of revenue). The majority of the L3Harris' sales are to the U.S. Government or to other defense contractors. The combined companies have pro forma revenue of over $16B in 2018. The current market capitalization is about $46.7B.

L3Harris reported pro forma combined results for Q2 2019 and 1H 2019 on July 31, 2019. Revenue for Q2 2019 increased 7% to $4,448M from $4,164M and diluted non-GAAP EPS increased 28% to $2.42 from $1.89 on year-over-year basis. For 1H 2019, revenue increased 10% to $8,834M from $8,012M and diluted non-GAAP EPS increased 27% to $4.65 from $3.65 in comparable periods. Integrated Mission Systems segment revenue increased 3% to $1,249M from $1,211M in the prior year due to growth from electro optical airborne imaging systems and ISR aircraft missionization. Operating margins increased 110 bps to 12.6% from 11.5% in the same time period. Revenue for Space & Airborne Systems increased 17% to $1,195M from $1,021M and operating margins expanded 120 bps to 18.8% from 17.6% in comparable periods. Growth came from avionics, electronic warfare, and classified space programs. Communications systems revenue increased 6% to $1,083M from $1,020M and operating margins expanded 80 bps to 21.6% from 20.8% in the prior year on strength of DoD tactical and public safety offset by UAE ELTS program and night vision. Aviation Systems revenue increased 2% to $964M from $949M and operating margins expanded 90 bps to 10.5% from 9.6% on year-over-year basis on growth in airport security equipment and FAA program offset by C-17 training loss and lower volumes for commercial flight simulators.

L3Harris full year guidance was 9.5% - 10.5% increase in revenue ranging from $9.2B - $9.3B, companywide operating margins of ~16.2%, and EPS of $9.60 - $9.70. The company is forecasting $500M in gross cost merger synergies.

Growth on a Per-Share Basis[1]

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	$3.87	$4.28	$4.60	$4.80	$4.92	$5.00	$5.14	$5.70	$5.12	$6.38	***$9.65***	***$15.54***
DPS	$0.80	$0.88	$1.00	$1.22	$1.48	$1.68	$1.88	$2.00	$2.12	$2.28	***$2.74***	***$4.83***
Shares[2]	131.37	127.46	123.12	112.15	106.93	105.51	123.68	124.64	119.63	118.28	***224***	***202.5***

L3Harris has only a short operating history of a couple of months. But the new company is positioned for both top and bottom line growth in high margin market segments. Increased defense spending will support top line growth. Both predecessor organizations have a history of increasing EPS and DPS. We are currently forecasting average annual EPS growth of 10% out to 2024. Bottom line growth will be driven by organic sales increases, higher margins, and robust share buybacks. The bottom line will also benefit from cost synergies from the recent merger. The new company has

[1] Note that L3Harris is the successor organization to Harris and thus tabular data before 2019 is for Harris.

[2] Share count is in millions.

L3Harris Technologies (LHX)

Updated August 17th, 2019 by Prakash Kolli

signaled in the quarterly earnings release that FCF will deployed through increased dividends and share buybacks. We are forecasting 12% average annual increase in dividends out to 2024 due to the low payout ratio of 28.4%.

Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	9.8	9.9	10.1	8.3	9.6	13.3	14.2	13.9	19.7	22.2	***21.9***	***16.0***
Avg. Yld.	2.1%	2.1%	2.2%	3.1%	3.1%	2.5%	2.6%	2.5%	2.1%	1.6%	***1.3%***	***1.9%***

L3Harris' current PE ratio of 21.9 using expected 2019 EPS is greater than its 10-year average of 13.0 for Harris and 15.0 for L3 suggesting that the stock is overvalued on this metric. We believe that the PE ratio will decrease to 16.0 over the next 5-years. The stock has traded in the past at a PE ratio below that of the S&P 500's average. But investors have bid up the stock price as results have improved results and also due to expected increases in DoD spending. Our current fair value estimate is $154. Our 5-year price target is $249.

Safety, Quality, Competitive Advantage, & Recession Resiliency

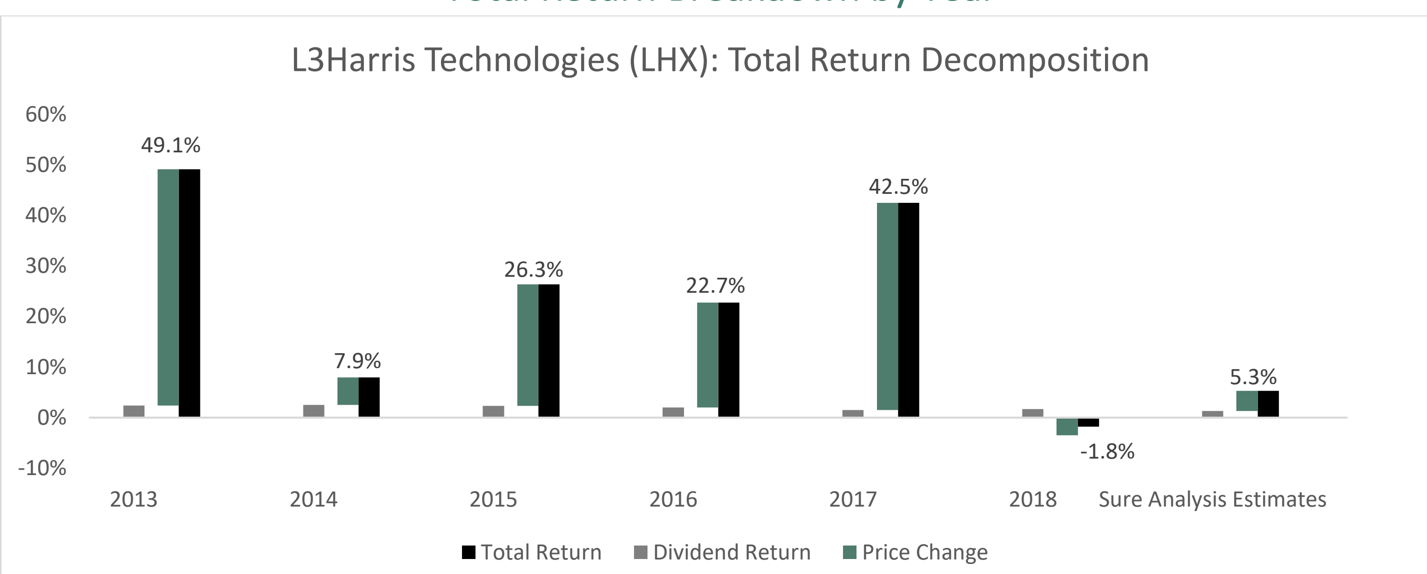
Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2023
Payout	20.7%	20.6%	21.7%	25.4%	30.1%	33.6%	36.6%	35.1%	41.4%	35.7%	***28.4%***	***31.1%***

As a large defense contractor L3Harris has competitive advantages related to defense contracting, which often requires knowledge of acquisition regulations and accounting standards particularly for large programs. The company develops and manufactures complex and bespoke systems for the DoD requiring a skilled work force with security clearances that is not easily replicated. Furthermore, L3Harris has built long-term relationships with both the DoD and prime contractors in its areas of expertise. These attributes make it somewhat recession resistant. But the company may experience top and bottom line declines if defense programs are cut or the defense budget is decreased.

Final Thoughts & Recommendation

We are forecasting 5.3% annual returns over the next five years comprised of 1.3% yield, 10.0% earnings growth, and (6.0%) from multiple contraction. The company has potential for long term growth due to the merger, but we currently view the stock as overvalued and the dividend yield is low. We view this stock as a hold for current investors.

Total Return Breakdown by Year



Click here to rate and review this research report. Your feedback is important to us.

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

L3Harris Technologies (LHX)

Updated August 17th, 2019 by Prakash Kolli

Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	15615	13390	13154	13107	11420	10986	9231	9210	9573	10244
Gross Profit	1656	1485	1441	1308	1117	1012	862	2245	2551	2707
Gross Margin	10.6%	11.1%	11.0%	10.0%	9.8%	9.2%	9.3%	24.4%	26.6%	26.4%
SG&A Exp.	N/A	N/A	N/A	N/A	N/A	N/A	N/A	1287	1520	1601
D&A Exp.	218	212	230	228	202	214	203	198	225	241
Operating Profit	1656	1485	1441	1308	1117	1012	862	958	1031	1106
Op. Margin	10.6%	11.1%	11.0%	10.0%	9.8%	9.2%	9.3%	10.4%	10.8%	10.8%
Net Profit	901	955	958	784	751	664	-240	710	677	1005
Net Margin	5.8%	7.1%	7.3%	6.0%	6.6%	6.0%	-2.6%	7.7%	7.1%	9.8%
Free Cash Flow	1221	1283	1297	1096	1059	968	930	831	878	800
Income Tax	475	428	296	360	264	227	132	171	102	103

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	14813	15451	15508	13800	14007	13715	12069	11865	12729	13518
Cash & Equivalents	1016	607	764	349	500	442	207	363	662	1066
Acc. Receivable	1149	1299	1093	968	991	803	746	700	723	919
Inventories	239	303	317	358	366	288	333	330	389	879
Goodwill & Int.	8567	9200	7780	8090	8081	6707	6480	6603	6907	7190
Total Liabilities	8153	8596	8784	8273	7951	8355	7640	7241	7578	7611
Accounts Payable	464	463	395	505	535	346	297	419	531	699
Long-Term Debt	4112	4137	4125	3629	3630	3939	3626	3325	3330	3321
Total Equity	6567	6764	6635	5451	5981	5285	4355	4553	5083	5839
D/E Ratio	0.63	0.61	0.62	0.67	0.61	0.75	0.83	0.73	0.66	0.57

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	6.2%	6.3%	6.2%	5.4%	5.4%	4.8%	-1.9%	5.9%	5.5%	7.7%
Return on Equity	14.5%	14.3%	14.3%	13.0%	13.1%	11.8%	-5.0%	15.9%	14.1%	18.4%
ROIC	8.5%	8.8%	8.8%	7.8%	8.0%	7.0%	-2.8%	8.9%	8.2%	11.4%
Shares Out.	115.4	108.6	98.9	90.4	85.6	82.5	78.1	77.2	77.9	78.8
Revenue/Share	133.0	116.33	124.56	134.29	125.36	125.13	112.71	116.88	120.26	128.69
FCF/Share	10.40	11.15	12.28	11.23	11.62	11.03	11.36	10.55	11.03	10.05

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.