L3Harris Technologies (LHX)

Updated December 16th, 2019 by Prakash Kolli

Key Metrics

Current Price:	$200	**5 Year CAGR Estimate:**	6.9%	**Market Cap:**	$44,253M
Fair Value Price:	$161	**5 Year Growth Estimate:**	10.0 %	**Ex-Dividend Date:**	11/21/19
% Fair Value:	125%	**5 Year Valuation Multiple Estimate:**	-4.3%	**Dividend Payment Date:**	12/06/19
Dividend Yield:	1.5%	**5 Year Price Target**	$259	**Years Of Dividend Growth:**	18
Dividend Risk Score:	A	**Retirement Suitability Score:**	C	**Last Dividend Increase:**	14.3%

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 now 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 had pro forma revenue of over $16B in 2018.

L3Harris reported strong results for Q3 2019 on October 30, 2019. Revenue increased 10% to $4,408M from $4,010M (pro forma prior year) and diluted non-GAAP EPS increased 26% to $2.58 from $2.42 (pro forma prior year) on year-over-year basis due to the merger and organic growth. The newly merged company is off to a strong start showing double-digit growth and also strong margin expansion. Integrated Mission Systems segment revenue increased 10% to $1,303M from $1,186M in the prior year due to growth from ISR aircraft missionization and Westcam turret system sales. Operating margins increased 160 bps to 13.8% from 12.2% in the same time period. Revenue for Space & Airborne Systems increased 20% to $1,162M from $971M and operating margins expanded 250 bps to 19.4% from 16.9% in comparable periods. Growth came from avionics and electronic warfare on F-35, F/A-18, and F-16 platforms and space. Communications systems revenue increased 11% to $1,032M from $933M and operating margins expanded 140 bps to 22.7% from 21.3% in the prior year on strength of tactical and public safety communication systems. Aviation Systems revenue was flat at $948M from $953M, but operating margins expanded 330 bps to 13.4% from 10.1% on a year-over-year basis due to C-17 training loss and lower volumes for commercial flight simulators. L3Harris continues to win orders in its market areas and the backlog grew 10% to $16.5B. The book-to-bill ratio is 1.13 indicating healthy win rates. L3Harris full year guidance was revised up for revenue to ~$18.1B and non-GAAP EPS of ~$10.00.

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	***$10.04***	***$16.17***
DPS	$0.80	$0.88	$1.00	$1.22	$1.48	$1.68	$1.88	$2.00	$2.12	$2.28	***$3.00***	***$4.83***
Shares[2]	131	127	123	112	107	106	124	125	120	118	***224***	***203***

L3Harris has only a short operating history of a few 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 signaled in that free cash flow will deployed through increased dividends and share buybacks. We are forecasting 10% average annual increase in dividends out to 2024 due to the low payout ratio of ~30%.

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[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.

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.

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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	***19.9***	***16.0***
Avg. Yld.	2.1%	2.1%	2.2%	3.1%	3.1%	2.5%	2.6%	2.5%	2.1%	1.6%	***1.5%***	***1.9%***

L3Harris' stock price has declined since our last report. It now trades at an earnings multiple of ~19.9. But this is still elevated relative to our long-term estimate of 16.0. We have adjusted our earnings estimate upward due to higher revenue and margins. Our current fair value estimate is now $161. Our 5-year price target is now $259.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2023
Payout	21%	21%	22%	25%	30%	34%	37%	35%	41%	36%	***30%***	***30%***

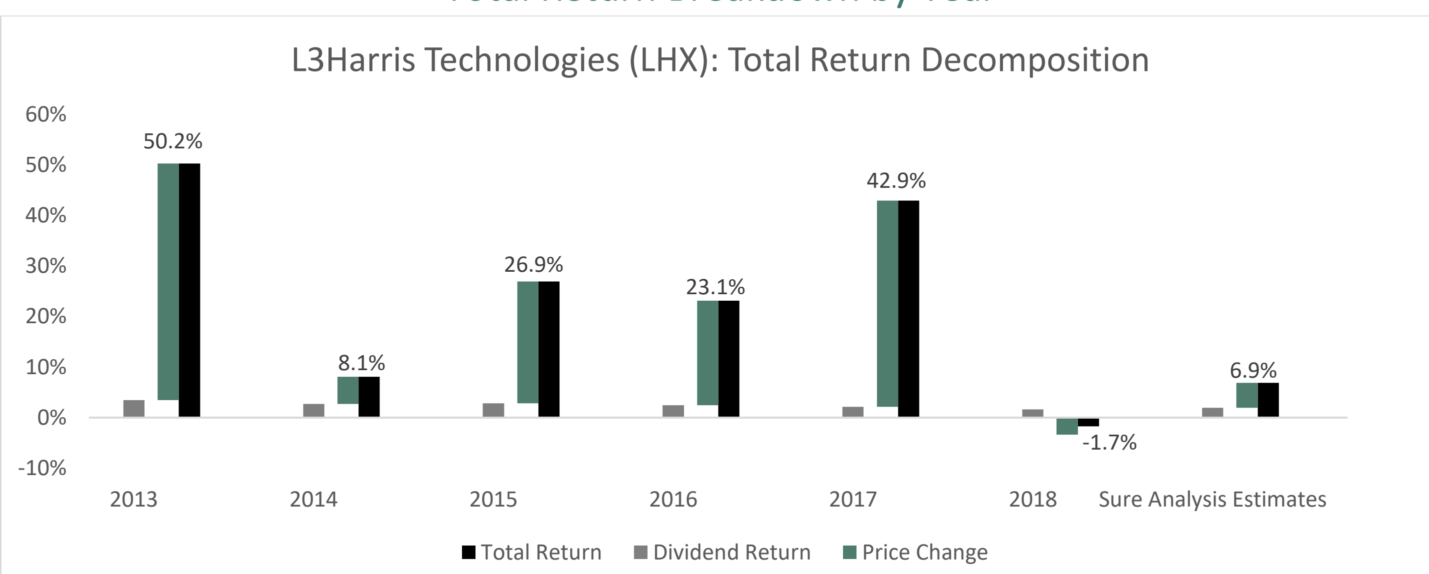
As a large defense contractor L3Harris has competitive advantages related to defense contracting, which often requires knowledge of acquisition regulations and accounting standards particularly for large programs. The company develops and manufactures complex and bespoke systems for the DoD requiring 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.

L3Harris took on debt to fund the merger. Short-term debt now stands at $659M and long-term debt is now $6,307M offset by cash and equivalents of $1,001M. Despite the increase, interest coverage is healthy at about 10X.

Final Thoughts & Recommendation

We are forecasting 6.9% annual returns over the next five years up from our last report due to a decline in stock price. The company has potential for long term growth due to the merger and involvement in core platforms. The company is spending heavily on R&D and expanding its presence on long-term platforms which bodes well for earnings. But we currently view the stock as overvalued and the dividend yield is low. We view this stock as a hold for current investors at the current price.

Total Return Breakdown by Year



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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.

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