L3Harris Technologies (LHX)

Updated May 18th, 2020 by Prakash Kolli

Key Metrics

Current Price:	$181	**5 Year CAGR Estimate:**	11.8%	**Market Cap:**	$39.1B
Fair Value Price:	$182	**5 Year Growth Estimate:**	10.0 %	**Ex-Dividend Date:**	06/01/20
% Fair Value:	100%	**5 Year Valuation Multiple Estimate:**	0.1%	**Dividend Payment Date:**	06/16/20
Dividend Yield:	1.9%	**5 Year Price Target**	$292	**Years Of Dividend Growth:**	18
Dividend Risk Score:	A	**Retirement Suitability Score:**	C	**Last Dividend Increase:**	18.5%

Overview & Current Events

L3Harris Technologies (LHX) is the result of a merger between L3 Technologies and Harris Corporation completed on June 29, 2019 forming 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 $18B in 2019.

L3Harris reported strong results for Q2 2020 on May 5, 2020. Companywide revenue increased 5% to $4,626M from $4,386M (pro forma prior year) and diluted non-GAAP EPS increased 21% to $2.80 from $2.32 (pro forma prior year) on year-over-year basis due to the merger and organic growth. Integrated Mission Systems segment revenue increased 1% to $1,370M from $1,362M in the prior year due to growth in maritime programs offset by electro-optical. This segment continues to win orders on aircraft and UAVs, and the book-to-bill ratio is up to 1.37. Revenue for Space & Airborne Systems increased 7% to $1,192M from $1,112M. Growth came from avionics on the F-35, and classified growth in intel and cyber. L3Harris won a large contract for MOSSAIC. The book-to-bill ratio is now 1.16. Communications systems revenue increased 5% to $1,094M from $1,041M due to ramp ups in U.S. DoD tactical communications offset by international tactical radios and public safety. The book-to-bill has dropped to 0.80. Aviation Systems revenue increased 11% to $1,011M from $914M, driven by defense aviation and mission networks. Commercial aviation weakened.

L3Harris completed the divesture of airport security and automation for $1B in cash. L3Harris is planning to divest another 8-10% of revenue. The company adjusted guidance downward due to COVID-19 but is still expecting top line growth and merger synergies to drive an increase in the bottom line.

Growth on a Per-Share Basis[1]

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	$4.28	$4.60	$4.80	$4.92	$5.00	$5.14	$5.70	$5.12	$6.38	$10.08	***$11.35***	***$18.28***
DPS	$0.88	$1.00	$1.22	$1.48	$1.68	$1.88	$2.00	$2.12	$2.28	$2.87	***$3.40***	***$5.48***
Shares[2]	127	123	112	107	106	124	125	120	118	224	***220***	***198***

L3Harris has only a short operating history of several 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 earnings and dividends. We are currently forecasting average annual earnings per share growth of 10% out to 2025. 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 that free cash flow will deployed through increased dividends and share buybacks. We are forecasting 10% average annual increase in dividends out to 2025 due to the low payout ratio.

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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.

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Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	9.9	10.1	8.3	9.6	13.3	14.2	13.9	19.7	22.2	20.3	***15.9***	***16.0***
Avg. Yld.	2.1%	2.2%	3.1%	3.1%	2.5%	2.6%	2.5%	2.1%	1.6%	1.7%	***1.9%***	***1.9%***

L3Harris' stock price has dropped since our last report due to the general market downturn resulting from COVID-19. We believe that over long-term a fair value multiple is about 16X. We have adjusted our earnings estimate downward due to expected weakness in commercial aviation. Our current fair value estimate is $182. Our 5-year price target is now $292.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	21%	22%	25%	30%	34%	37%	35%	41%	36%	28%	***30%***	***30%***

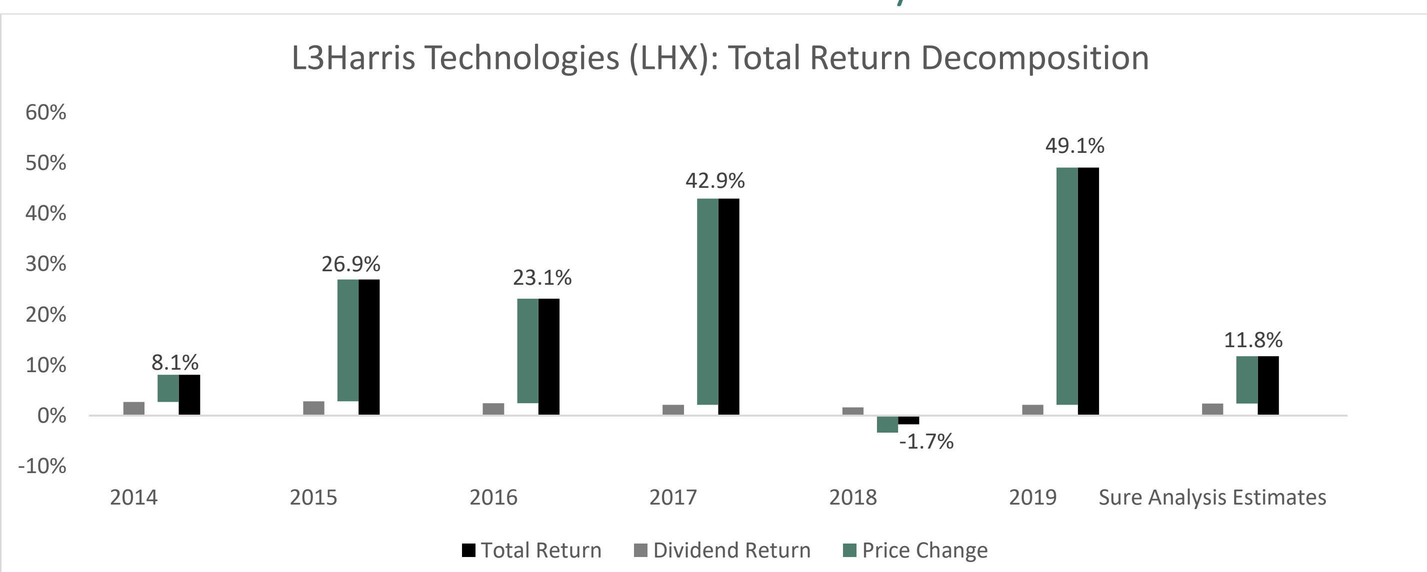
As a large defense contractor L3Harris has competitive advantages related to defense contracting, which often requires knowledge of acquisition regulations and accounting standards particularly for large programs. The company develops and manufactures complex and bespoke systems for the DoD requiring a skilled work force with security clearances that is not easily replicated. Notably, L3Harris is the market leader in tactical communications. 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 $2,318M and long-term debt is now $6,294M offset by cash and equivalents of $663M. Interest coverage is healthy at over 9X, and the leverage ratio is about 2X.

Final Thoughts & Recommendation

We are forecasting 11.8% annualized total returns over the next five years. The company's upward trend in stock price was interrupted by the recent market downturn. L3Harris is reducing leverage and increasing margins. The company is focused in higher growth areas of the U.S. DoD budget. Investors may find this stock appealing for dividend growth. At the current stock price, we rate this stock a buy.

Total Return Breakdown by Year



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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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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	13390	13154	13107	11420	10986	9231	9210	9573	10244	6801
Gross Profit	1485	1441	1308	1117	1012	862	2245	2551	2707	2334
Gross Margin	11.1%	11.0%	10.0%	9.8%	9.2%	9.3%	24.4%	26.6%	26.4%	34.3%
SG&A Exp.	N/A	N/A	N/A	N/A	N/A	N/A	1287	1520	1601	1242
D&A Exp.	212	230	228	202	214	203	198	225	241	258
Operating Profit	1485	1441	1308	1117	1012	862	958	1031	1106	1092
Op. Margin	11.1%	11.0%	10.0%	9.8%	9.2%	9.3%	10.4%	10.8%	10.8%	16.1%
Net Profit	955	958	784	751	664	-240	710	677	1005	949
Net Margin	7.1%	7.3%	6.0%	6.6%	6.0%	-2.6%	7.7%	7.1%	9.8%	14.0%
Free Cash Flow	1283	1297	1096	1059	968	930	831	878	800	1024
Income Tax	428	296	360	264	227	132	171	102	103	160

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	15451	15508	13800	14007	13715	12069	11865	12729	13518	10117
Cash & Equivalents	607	764	349	500	442	207	363	662	1066	530
Acc. Receivable	1299	1093	968	991	803	746	700	723	919	457
Inventories	303	317	358	366	288	333	330	389	879	360
Goodwill & Int.	9200	7780	8090	8081	6707	6480	6603	6907	7190	6210
Total Liabilities	8596	8784	8273	7951	8355	7640	7241	7578	7611	6754
Accounts Payable	463	395	505	535	346	297	419	531	699	525
Long-Term Debt	4137	4125	3629	3630	3939	3626	3325	3330	3321	3522
Total Equity	6764	6635	5451	5981	5285	4355	4553	5083	5839	3363
D/E Ratio	0.61	0.62	0.67	0.61	0.75	0.83	0.73	0.66	0.57	1.05

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	6.3%	6.2%	5.4%	5.4%	4.8%	-1.9%	5.9%	5.5%	7.7%	9.5%
Return on Equity	14.3%	14.3%	13.0%	13.1%	11.8%	-5.0%	15.9%	14.1%	18.4%	28.6%
ROIC	8.8%	8.8%	7.8%	8.0%	7.0%	-2.8%	8.9%	8.2%	11.4%	13.6%
Shares Out.	127	123	112	107	106	124	125	120	118	224
Revenue/Share	116.33	124.56	134.29	125.36	125.13	112.71	116.88	120.26	128.69	56.44
FCF/Share	11.15	12.28	11.23	11.62	11.03	11.36	10.55	11.03	10.05	8.50

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