L3Harris Technologies (LHX)

Updated February 3rd, 2021 by Prakash Kolli

Key Metrics

Current Price:	$180	**5 Year CAGR Estimate:**	14.7%	**Market Cap:**	$37.93B
Fair Value Price:	$205	**5 Year Growth Estimate:**	10.0 %	**Ex-Dividend Date:**	11/19/20
% Fair Value:	88%	**5 Year Valuation Multiple Estimate:**	2.7%	**Dividend Payment Date:**	12/04/20
Dividend Yield:	2.3%	**5 Year Price Target**	$330	**Years Of Dividend Growth:**	20
Dividend Risk Score:	A	**Retirement Suitability Score:**	B	**Last Dividend Increase:**	20%

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: 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 revenue of about $18.2B in 2020.

L3Harris reported Q4 2020 and full year results on January 29, 2021. Companywide revenue was down -3.6% at $4,660M from $4,832M (pro forma prior year) and diluted non-GAAP EPS increased 10% to $3.14 from $2.85 (pro forma prior year) on year-over-year basis due to merger synergies. For the full-year revenue was up +0.5% to $18,194M from $18,097M (pro forma prior year) and diluted non-GAAP EPS increased 13% to $11.60 from $10.26 (pro forma prior year).

Integrated Mission Systems segment revenue was flat at $1,465M from $1,466M in the prior year due to growth in Maritime programs offset by declines in ISR and Electro Optical. Revenue for Space & Airborne Systems increased 4.3% to $1,256M from $1,204M. Growth came from F-35 Mission Avionics and Space offset by a decline in Cyber. Communications systems revenue increased 2.1% to $1,143M from $1,119M due to growth in Tactical Communications offset by declines in Public Safety and Integrated Vision Solutions. Aviation Systems revenue fell -22% to $845M from $1,090M due to weakness in Commercial Aviation offset by growth in Defense Aviation and Mission Networks. COVID-19 continues to negatively impact the Commercial Aviation business as well as Public Safety.

The company guided for 3.0% – 5.0% organic revenue growth and EPS of $12.60 - $13.00 in 2021.

Growth on a Per-Share Basis[1]

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
EPS	$4.60	$4.80	$4.92	$5.00	$5.14	$5.70	$5.12	$6.38	$10.08	***$11.60***	***$12.80***	***$20.61***
DPS	$1.00	$1.22	$1.48	$1.68	$1.88	$2.00	$2.12	$2.28	$2.87	***$3.40***	***$4.04***	***$6.51***
Shares[2]	123	112	107	106	124	125	120	118	224	***213***	***206***	***177***

L3Harris has only a short operating history. 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 2026. The COVID-19 pandemic negatively impacted revenue in the commercial aviation business in 2020. 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. L3Harris announced a $6B (~16% of market capitalization) share repurchase program of which $2.3B will occur in 2021. L3Harris also raised the dividend 20% in 2021. We are forecasting on average 10% annual increase in dividends out to 2026 due to the low payout ratio.

[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 is long LHX.

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Valuation Analysis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
Avg. P/E	10.1	8.3	9.6	13.3	14.2	13.9	19.7	22.2	20.3	***16.3***	***14.0***	***16.0***
Avg. Yld.	2.2%	3.1%	3.1%	2.5%	2.6%	2.5%	2.1%	1.6%	1.7%	***1.8%***	***2.3%***	***2.0%***

L3Harris' stock price has declined since our last report similar to many defense stocks due to concern about future defense budgets. Despite headwinds from commercial aviation, L3Harris still saw a rise in earnings per share and margin expansion. The stock is trading below our fair value estimate of $205. Our 5-year price target is $330.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	22%	25%	30%	34%	37%	35%	41%	36%	28%	29%	***32%***	***32%***

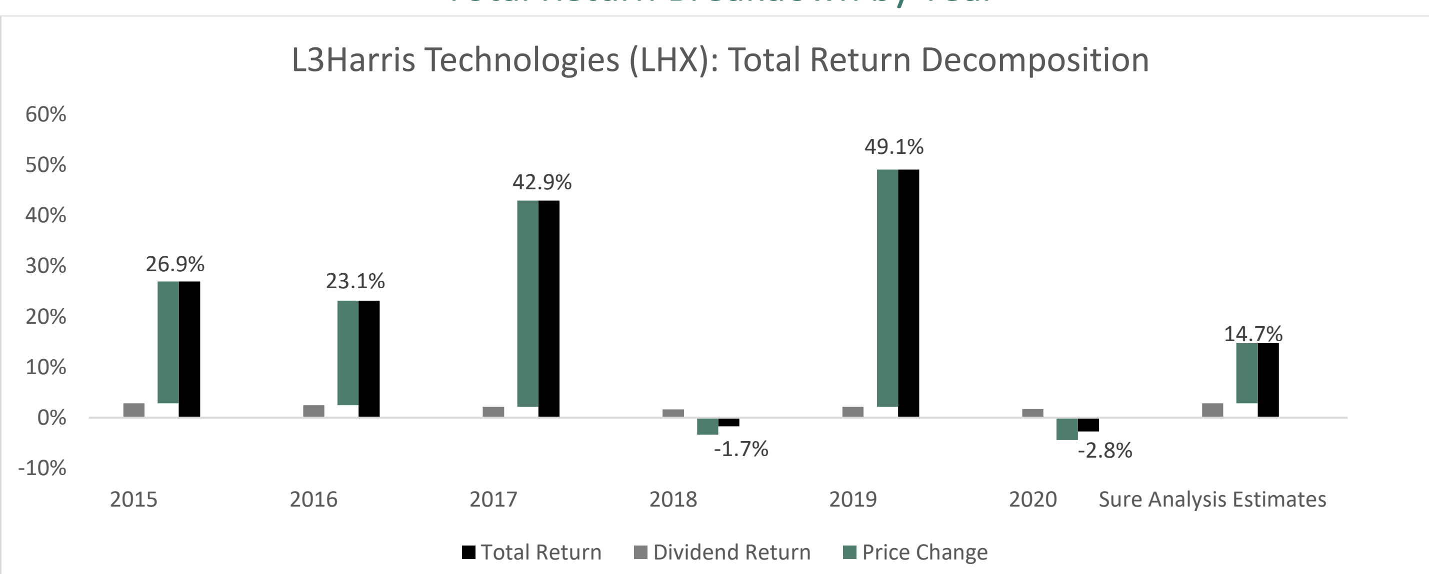
As a large defense contractor L3Harris has competitive advantages related to defense contracting, which often requires knowledge of acquisition regulations and accounting standards particularly for large programs. The company develops and manufactures complex and bespoke systems for the DoD requiring 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. COVID-19 is causing headwinds for commercial aviation and public safety.

L3Harris took on debt to fund the merger. Short-term debt now stands at $2M and long-term debt is now $6,908M offset by cash and equivalents of $1,276M. Interest coverage is decent at 7.5X, and the leverage ratio is about 2.1X.

Final Thoughts & Recommendation

We are forecasting 14.7% annualized total return over the next five years. L3Harris is well positioned to capitalize on the Pentagon's priorities. Merger synergies and margin expansion will likely make the defense contractor more profitable. Granted, commercial aviation is weak, but rising vaccination numbers may provide an improved outlook. The company is rapidly raising the dividend and it is well covered by earnings. At the current stock price, we rate this stock a strong buy.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	5,451	5,112	5,012	3,885	5,992	5,897	6,168	6,801	9,263	18,194
Gross Profit	1,882	1,727	1,702	1,515	2,160	2,043	2,102	2,334	2,537	5,308
Gross Margin	34.5%	33.8%	34.0%	39.0%	36.0%	34.6%	34.1%	34.3%	27.4%	29.2%
SG&A Exp.	941	914	820	883	1,105	1,150	1,182	1,242	1,881	3,315
D&A Exp.	260	221	204	244	361	311	259	258	442	1,032
Operating Profit	941	813	882	632	1,055	893	920	1,092	656	1,993
Op. Margin	17.3%	15.9%	17.6%	16.3%	17.6%	15.1%	14.9%	16.1%	7.1%	11.0%
Net Profit	31	113	535	334	324	543	699	949	822	1,119
Net Margin	0.6%	2.2%	10.7%	8.6%	5.4%	9.2%	11.3%	14.0%	8.9%	6.2%
Free Cash Flow	619	655	645	706	772	450	615	1,024	766	2,422
Income Tax	286	203	256	109	273	261	206	160	73	234

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets	5,593	4,858	4,919	13,127	12,009	10,090	9,851	10,117	38,336	36,960
Cash & Equivalents	356	321	561	481	487	484	288	530	824	1,276
Acc. Receivable	619	569	458	837	398	368	466	457	1,216	1,344
Inventories	618	669	619	1,015	867	841	411	360	1,219	973
Goodwill & Int.	2,117	2,000	1,969	8,123	6,583	6,470	6,361	6,210	28,459	26,784
Total Liabilities	3,647	3,297	3,094	9,725	8,952	7,162	6,573	6,754	15,592	16,119
Accounts Payable	381	340	324	581	494	540	622	525	1,261	1,406
Long-Term Debt	2,047	1,735	1,624	5,216	4,517	4,030	3,790	3,522	6,954	6,918
Total Equity	1,939	1,561	1,826	3,397	3,056	2,928	3,278	3,363	22,587	20,724
D/E Ratio	1.06	1.11	0.89	1.54	1.48	1.38	1.16	1.05	0.31	0.33

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets	0.5%	2.2%	10.9%	3.7%	2.6%	4.9%	7.0%	9.5%	3.4%	3.0%
Return on Equity	1.4%	6.5%	31.6%	12.8%	10.0%	18.1%	22.5%	28.6%	6.3%	5.2%
ROIC	0.7%	3.1%	15.9%	5.5%	4.0%	7.5%	10.0%	13.6%	4.5%	3.9%
Shares Out.	114.8	111.2	107.3	106.8	125	124.3	121.1	120.5	223.7	215.9
Revenue/Share	47.49	45.97	46.71	36.38	47.94	47.44	50.93	56.44	41.41	84.27
FCF/Share	5.39	5.89	6.01	6.61	6.18	3.62	5.08	8.50	3.42	11.22

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