



# L3Harris Technologies (LHX)

Updated February 2<sup>nd</sup>, 2023 by Prakash Kolli

## Key Metrics

<b>Current Price:</b>	\$216	<b>5 Year CAGR Estimate:</b>	8.1%	<b>Market Cap:</b>	\$41.10B
<b>Fair Value Price:</b>	\$196	<b>5 Year Growth Estimate:</b>	8.0%	<b>Ex-Dividend Date:</b>	03/10/23
<b>% Fair Value:</b>	110%	<b>5 Year Valuation Multiple Estimate:</b>	-1.9%	<b>Dividend Payment Date:</b>	03/25/23
<b>Dividend Yield:</b>	2.2%	<b>5 Year Price Target</b>	\$288	<b>Years Of Dividend Growth:</b>	21
<b>Dividend Risk Score:</b>	B	<b>Retirement Suitability Score:</b>	B	<b>Rating:</b>	Hold

## 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 three business segments: Integrated Mission Systems (~42% of revenue), Communication Systems (~23% of revenue), and Space and Airborne Systems (~35% of revenue). The majority of L3Harris' sales are to the US Government or to other defense contractors. The company had revenue of about \$17.1B in 2022.

L3Harris reported Q4 2022 results and full year on January 26<sup>th</sup>, 2023. For the quarter, companywide revenue rose 5% to \$4,578M from \$4,350M and diluted non-GAAP EPS decreased (-12%) to \$2.17 from \$2.46 on year-over-year basis on lower margins and supply chain disruptions. Diluted GAAP earnings fell (-1%) to \$3.27 from \$3.20 in comparable periods. Integrated Mission Systems segment revenue fell (-2%) to \$1,850M from \$1,812M in the prior year due to lower revenue in NATO aircraft, Electro Optical, offset by gains in Maritime and new programs. Revenue for Space & Airborne Systems increased 7% to \$1,610M from \$1,501M. Growth came from Space, Intel & Cyber, and F-35 but offset by declines in legacy programs. Communications systems revenue increased 17% to \$1,193M from \$1,018M due to higher volumes in Tactical Communications, Public Safety, offset by a decrease in Integrated Vision Solutions.

For the year, revenue fell (-4%) to \$17,062M from \$17,814M and adjusted EPS declined to \$12.90 from \$12.95.

The funded book-to-bill ratio was 1.08X. The firm closed on the \$2B acquisition Viasat's TDL product line, Link 16.

L3Harris is acquiring Aerojet Rocketdyne for \$4.7B, subject to regulatory and shareholder approvals.

The company guided for ~\$17.4B - \$17.8B in revenue and \$12.00 - \$12.50 for EPS in 2023.

## Growth on a Per-Share Basis<sup>1</sup>

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
<b>EPS</b>	\$4.92	\$5.00	\$5.14	\$5.70	\$5.12	\$6.38	\$10.08	\$11.60	\$12.95	\$12.90	<b>\$12.25</b>	<b>\$18.00</b>
<b>DPS</b>	\$1.48	\$1.68	\$1.88	\$2.00	\$2.12	\$2.28	\$2.87	\$3.40	\$4.08	\$4.48	<b>\$4.84</b>	<b>\$7.11</b>
<b>Shares<sup>2</sup></b>	107	106	124	125	120	118	216	206	193	<b>187</b>	<b>182</b>	<b>156</b>

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 over time. The COVID-19 pandemic impacted revenue in the commercial aviation business but is now recovering. The conflict in Ukraine should provide some tailwinds offset by supply chain disruptions and high labor costs. Bottom line growth will be driven by organic sales increases, higher margins, and robust share buybacks. Despite the slowdown, we are currently forecasting average annual earnings per share growth of 8% out to 2028. Both predecessor organizations have a history of increasing earnings and dividends. We are forecasting on average 8% annual increase in the dividend out to 2028 due to the relatively modest payout ratio.

<sup>1</sup> Note that L3Harris is the successor organization to Harris and thus tabular data before 2019 is for Harris.

<sup>2</sup> Share count is in millions.

Disclosure: This analyst is long LHX.



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## Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
Avg. P/E	9.6	13.3	14.2	13.9	19.7	22.2	20.3	36.2	23.4	16.7	17.6	16.0
Avg. Yld.	3.1%	2.5%	2.6%	2.5%	2.1%	1.6%	1.7%	1.8%	1.9%	2.1%	2.2%	2.5%

L3Harris' stock price is down again since our last report because of mixed results and lower guidance. We set our earnings estimate to the mid-point of 2023 guidance. Our fair value multiple is 16X, discounting for merger uncertainties and inflation. The stock is trading above our fair value estimate of \$196. Our 5-year price target is now \$288.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	30%	34%	37%	35%	41%	36%	28%	29%	32%	35%	40%	40%

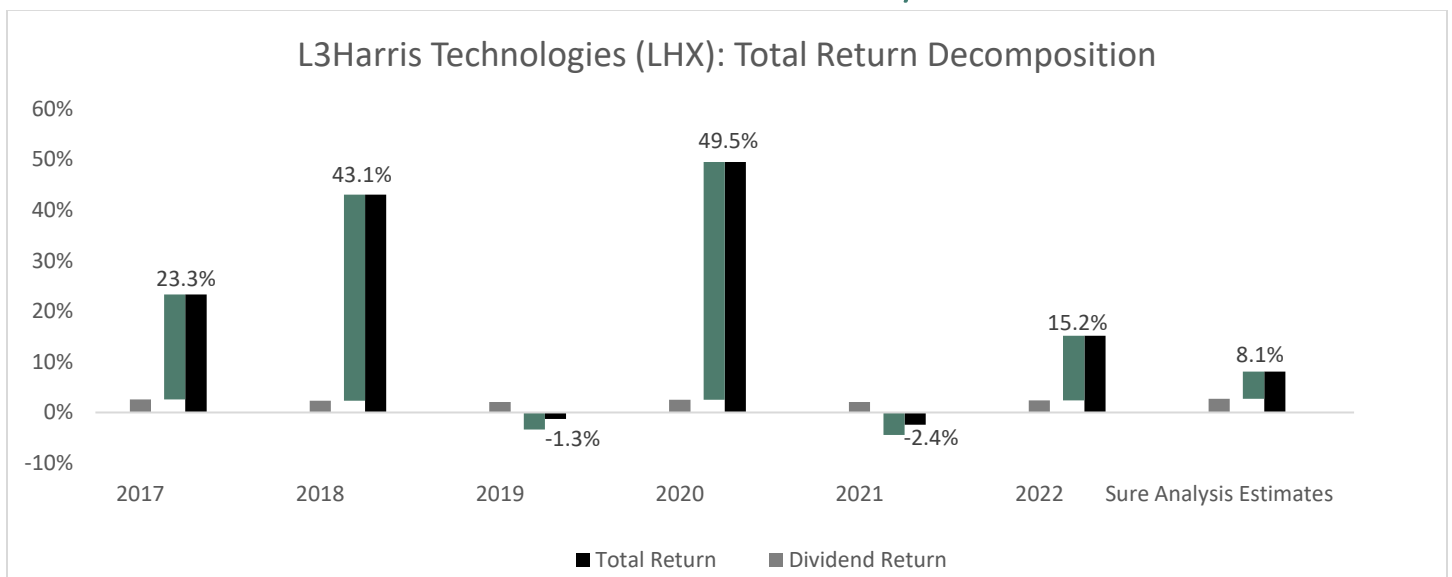
As a large defense contractor L3Harris has competitive advantages related to defense contracting, which often requires knowledge of acquisition regulations and accounting standards, particularly for large programs. The company develops and manufactures complex and bespoke systems for the DoD requiring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

L3Harris took on debt to fund the merger. Short-term debt is \$2M, current long-term debt is \$818M, and long-term debt is \$6,225M offset by cash and equivalents of \$880M. Interest coverage is 6.9X, and the leverage ratio is about 2.3X.

## Final Thoughts & Recommendation

We are forecasting 8.1% annualized total return over the next five years from a dividend yield of 2.2%, 8% EPS growth, and (-1.9%) P/E multiple contraction. L3Harris is being impacted by labor costs, supply chain issues, and the global shortage of electronic components affecting revenue growth. But growing global defense budgets and the Russo-Ukrainian conflict are providing a tailwind. At the current stock price, we rate this stock a hold.

## Total Return Breakdown by Year



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## Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
<b>Revenue</b>	5,112	5,012	3,885	5,992	5,897	6,168	6,801	9,263	18,194	17,814
<b>Gross Profit</b>	1,727	1,702	1,515	2,160	2,043	2,102	2,334	2,537	5,308	5,376
<b>Gross Margin</b>	33.8%	34.0%	39.0%	36.0%	34.6%	34.1%	34.3%	27.4%	29.2%	30.2%
<b>SG&amp;A Exp.</b>	914	820	883	1,105	1,150	1,182	1,242	1,881	3,315	3,280
<b>D&amp;A Exp.</b>	221	204	244	361	311	259	258	442	1,032	967
<b>Operating Profit</b>	813	882	632	1,055	893	920	1,092	656	1,993	2,096
<b>Op. Margin</b>	15.9%	17.6%	16.3%	17.6%	15.1%	14.9%	16.1%	7.1%	11.0%	11.8%
<b>Net Profit</b>	113	535	334	324	543	699	949	822	1,119	1,846
<b>Net Margin</b>	2.2%	10.7%	8.6%	5.4%	9.2%	11.3%	14.0%	8.9%	6.2%	10.4%
<b>Free Cash Flow</b>	655	645	706	772	450	615	1,024	766	2,422	2,352
<b>Income Tax</b>	203	256	109	273	261	206	160	73	234	440

## Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
<b>Total Assets</b>	4,858	4,919	13,127	12,009	10,090	9,851	10,117	38,336	36,960	34,709
<b>Cash &amp; Equivalents</b>	321	561	481	487	484	288	530	824	1,276	941
<b>Acc. Receivable</b>	569	458	837	398	368	466	457	1,216	1,344	1,045
<b>Inventories</b>	669	619	1,015	867	841	411	360	1,219	973	982
<b>Goodwill &amp; Int.</b>	2,000	1,969	8,123	6,583	6,470	6,361	6,210	28,459	26,784	24,830
<b>Total Liabilities</b>	3,297	3,094	9,725	8,952	7,162	6,573	6,754	15,592	16,119	15,390
<b>Accounts Payable</b>	340	324	581	494	540	622	525	1,261	1,406	1,767
<b>Long-Term Debt</b>	1,735	1,624	5,216	4,517	4,030	3,790	3,522	6,954	6,918	7,061
<b>Total Equity</b>	1,561	1,826	3,397	3,056	2,928	3,278	3,363	22,587	20,724	19,320
<b>LTD/E Ratio</b>	1.11	0.89	1.54	1.48	1.38	1.16	1.05	0.31	0.33	0.37

## Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
<b>Return on Assets</b>	2.2%	10.9%	3.7%	2.6%	4.9%	7.0%	9.5%	3.4%	3.0%	5.2%
<b>Return on Equity</b>	6.5%	31.6%	12.8%	10.0%	18.1%	22.5%	28.6%	6.3%	5.2%	9.2%
<b>ROIC</b>	3.1%	15.9%	5.5%	4.0%	7.5%	10.0%	13.6%	4.5%	3.9%	6.8%
<b>Shares Out.</b>	111.2	107.3	106.8	125	124.3	121.1	120.5	223.7	215.9	203.2
<b>Revenue/Share</b>	45.97	46.71	36.38	47.94	47.44	50.93	56.44	41.41	84.27	87.67
<b>FCF/Share</b>	5.89	6.01	6.61	6.18	3.62	5.08	8.50	3.42	11.22	11.57

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

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