L3Harris Technologies (LHX)

Updated May 5th, 2023 by Prakash Kolli

Key Metrics

Current Price:	$186	**5 Year CAGR Estimate:**	11.2%	**Market Cap:**	$35.219B
Fair Value Price:	$196	**5 Year Growth Estimate:**	8.0%	**Ex-Dividend Date:**	06/01/23
% Fair Value:	95%	**5 Year Valuation Multiple Estimate:**	1.0%	**Dividend Payment Date:**	06/16/23
Dividend Yield:	2.4%	**5 Year Price Target**	$288	**Years Of Dividend Growth:**	22
Dividend Risk Score:	B	**Retirement Suitability Score:**	B	**Rating:**	Buy

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 Q1 2023 results on April 27th, 2023. Companywide revenue rose 9% to $4,471M from $4,103M and diluted non-GAAP EPS decreased (-9%) to $2.86 from $3.14 on year-over-year basis on higher pension and interest costs, and inflation. Diluted GAAP earnings fell (-28%) to $1.76 from $2.44 in comparable periods on a business sale.

Integrated Mission Systems segment revenue climbed 2% to $1,700M from $1,659M in the prior year due to higher revenue in Commercial Aviation, Electro Optical, offset by lower sales in classified Maritime. Revenue for Space & Airborne Systems increased 9% to $1,655M from $1,517M. Growth came from Space, Intel & Cyber, Mission Avionics, and Mission Networks but offset by declines in Electronic Warfare. Communications systems revenue increased 21% to $1,163M from $963M due to higher volumes in Broadband Communications, Tactical Communications, Public Safety, offset by a decrease in Integrated Vision Solutions.

The funded book-to-bill ratio rose to 1.31X. The company won $5.8B in awards and total backlog is $24.5B.

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

The company maintained its guidance at ~$17.4B - $17.8B in revenue and $12.00 - $12.50 for EPS in 2023.

Growth on a Per-Share Basis[1]

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
EPS	$4.92	$5.00	$5.14	$5.70	$5.12	$6.38	$10.08	$11.60	$12.95	$12.90	***$12.25***	***$18.00***
DPS	$1.48	$1.68	$1.88	$2.00	$2.12	$2.28	$2.87	$3.40	$4.08	$4.48	***$4.56***	***$6.70***
Shares[2]	107	106	124	125	120	118	216	206	193	194	***188***	***181***

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 has recovered. 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.

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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 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	***15.2***	***16.0***
Avg. Yld.	3.1%	2.5%	2.6%	2.5%	2.1%	1.6%	1.7%	1.8%	1.9%	1.9%	***2.4%***	***2.3%***

L3Harris' stock price is down materially since our last report because of mixed results and fears of budget cuts. We set our earnings estimate to the mid-point of 2023 guidance. Our fair value multiple is 16X, discounting for inflation and rising costs. The stock is trading below 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%	***37%***	***37%***

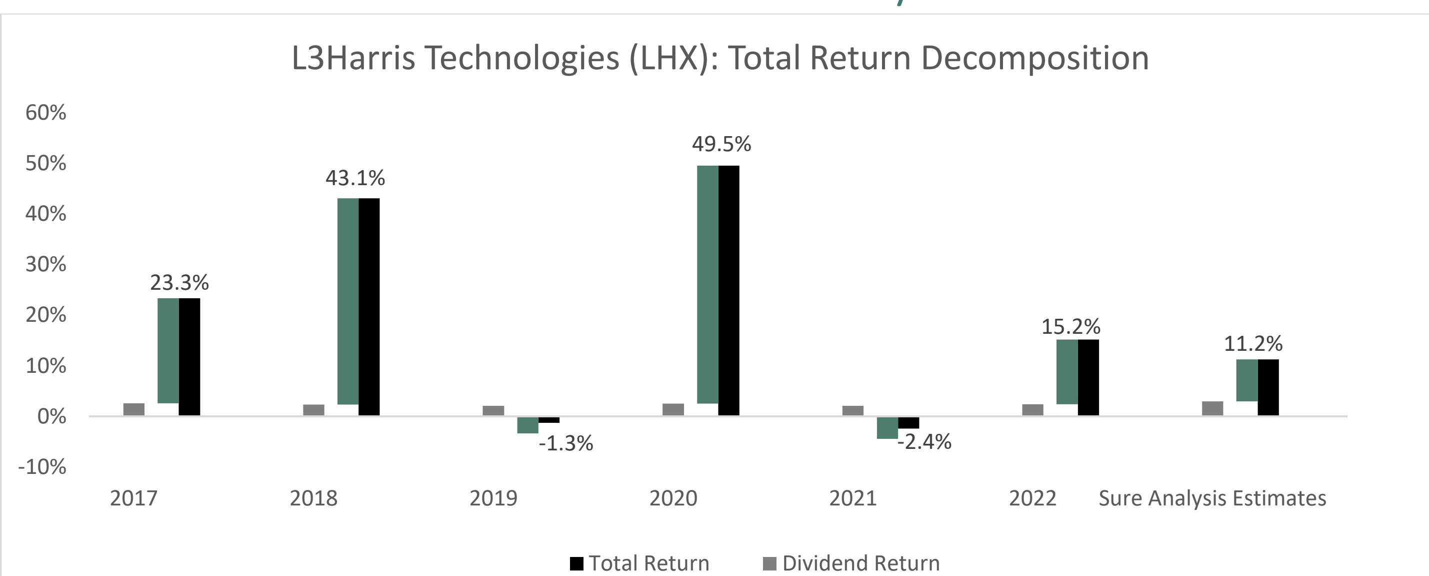
As a large defense contractor L3Harris has competitive advantages related to defense contracting, which often requires knowledge of acquisition regulations and accounting standards, particularly for large programs. The company develops and manufactures complex and bespoke systems for the DoD requiring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

L3Harris took on debt to fund the merger. Short-term debt is $2M, current long-term debt is $811M, and long-term debt is $8,220M offset by cash and equivalents of $545M. Interest coverage is 5.8X, and the leverage ratio is about 3.5X.

Final Thoughts & Recommendation

We are forecasting 11.2% annualized total return over the next five years from a dividend yield of 2.4%, 8% EPS growth, and 1.0% P/E multiple expansion. Inflation, pension costs, and higher interest payments are affecting earnings. But growing global defense budgets and the Russo-Ukrainian conflict are providing a tailwind. After recently acquiring Link 16, the firm bid $4.7B for Aerojet Rocketdyne. A decline in the stock price has resulted in a rating change to buy.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	5,012	3,885	5,992	5,897	6,168	6,801	9,263	18,194	17,814	17,062
Gross Profit	1,702	1,515	2,160	2,043	2,102	2,334	2,537	5,308	5,376	4,927
Gross Margin	34.0%	39.0%	36.0%	34.6%	34.1%	34.3%	27.4%	29.2%	30.2%	28.9%
SG&A Exp.	820	883	1,105	1,150	1,182	1,242	1,881	3,315	3,280	2,998
D&A Exp.	204	244	361	311	259	258	442	1,032	967	938
Operating Profit	882	632	1,055	893	920	1,092	656	1,993	2,096	1,929
Op. Margin	17.6%	16.3%	17.6%	15.1%	14.9%	16.1%	7.1%	11.0%	11.8%	11.3%
Net Profit	535	334	324	543	699	949	822	1,119	1,846	1,062
Net Margin	10.7%	8.6%	5.4%	9.2%	11.3%	14.0%	8.9%	6.2%	10.4%	6.2%
Free Cash Flow	645	706	772	450	615	1,024	766	2,422	2,352	1,906
Income Tax	256	109	273	261	206	160	73	234	440	212

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	4,919	13,127	12,009	10,090	9,851	10,117	38,336	36,960	34,709	33,524
Cash & Equivalents	561	481	487	484	288	530	824	1,276	941	880
Acc. Receivable	458	837	398	368	466	457	1,216	1,344	1,045	1,251
Inventories	619	1,015	867	841	411	360	1,219	973	982	1,291
Goodwill & Int.	1,969	8,123	6,583	6,470	6,361	6,210	28,459	26,784	24,830	23,284
Total Liabilities	3,094	9,725	8,952	7,162	6,573	6,754	15,592	16,119	15,390	14,900
Accounts Payable	324	581	494	540	622	525	1,261	1,406	1,767	1,945
Long-Term Debt	1,624	5,216	4,517	4,030	3,790	3,522	6,954	6,918	7,061	7,045
Total Equity	1,826	3,397	3,056	2,928	3,278	3,363	22,587	20,724	19,320	18,523
LTD/E Ratio	0.89	1.54	1.48	1.38	1.16	1.05	0.31	0.33	0.37	0.38

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	10.9%	3.7%	2.6%	4.9%	7.0%	9.5%	3.4%	3.0%	5.2%	3.1%
Return on Equity	31.6%	12.8%	10.0%	18.1%	22.5%	28.6%	6.3%	5.2%	9.2%	5.6%
ROIC	15.9%	5.5%	4.0%	7.5%	10.0%	13.6%	4.5%	3.9%	6.8%	4.1%
Shares Out.	107.3	106.8	125	124.3	121.1	120.5	223.7	215.9	203.2	193.5
Revenue/Share	46.71	36.38	47.94	47.44	50.93	56.44	41.41	84.27	87.67	88.18
FCF/Share	6.01	6.61	6.18	3.62	5.08	8.50	3.42	11.22	11.57	9.85

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